DAVIES

Governance Insights 2018

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Executive Summary

This year's edition of *Davies Governance Insights* coincides with the 10-year anniversary of the Supreme Court of Canada's seminal decision in *BCE Inc. v 1976 Debentureholders*, in which the Court first articulated the notion of a "good corporate citizen." Since that time, the corporate governance landscape has undergone a profound transformation. Massive changes in the technological, environmental, economic, political and regulatory environments, combined with rising investor engagement and scrutiny, have significantly expanded the range of issues taken up by public company boards of directors and the expectations placed upon them.

As companies grapple to keep up with evolving governance standards, the importance of board composition and competencies is a top priority. Today's leaders need to ensure they have the right mix of expertise in the boardroom to respond swiftly and effectively to ever-changing regulatory and market demands. Many of the challenges faced by companies in 2018 – from evolving technologies like blockchain to cybersecurity risk management to climate-related disclosure and executive compensation – require high levels of specialized knowledge and oversight. While not all issues will be material concerns for every issuer, in all cases, directors need to ensure they – and the management they rely on – have the required skills to properly address them and make informed choices about strategies for their particular context. This is especially the case as the broad range of governance issues and best practices undergo continued evolution, even if not always revolution.

In line with the increased focus on effective board composition, gender diversity continues to receive heightened attention from a variety of constituencies, with progress being driven by regulators, issuers, proxy advisory firms, pension funds and institutional investors. At the same time, the global #MeToo movement against sexual harassment and assault, which spread virally in October 2017, brings to the fore questions about the board's role in overseeing sexual misconduct risks and the steps companies should take to deter, investigate and report such behaviour. While some investors believe increasing gender representation and pay equity will help reduce future problems of this nature, others say that public accountability will force companies to progress at a faster pace. As a best practice, we recommend that companies adopt stand-alone sexual harassment policies, addressing confidential reporting and impartial investigation processes, the consequences of a validated claim, and specialized training for those charged with administering and enforcing the policy. Having appropriate sexual harassment policies and mitigation strategies in place may, in turn, become more important as "Weinstein clauses" – legal representations increasingly being requested of target companies about the behaviour of their management teams – emerge in the M&A space.

Layered on top of the diverse and complex issues facing today's boards is the increasing pressure on issuers to incorporate ethical and sustainable practices into their strategies and plans. Once strictly the purview of "socially responsible" investors, environmental, social and governance (ESG) matters have now become mainstream concerns, particularly in the areas of climate change risk and sustainability. On a

broader level, the movement reflects a pronounced focus on "good corporate governance" generally, and the evolving responsibility of corporate directors to consider the interests of a wider range of stakeholders, including shareholders, employees, suppliers, creditors, consumers and governments. Successfully navigating this investor landscape will increasingly require directors to consider their companies' roles in respect of ESG matters; correspondingly, such issues are likely to factor into assessments of directors' compliance with their baseline corporate and securities laws duties and responsibilities.

Lastly, it bears mentioning that, in all contexts, a sound, well-defined engagement program will help a company build relationships with shareholders, gain insight into their views on a multitude of issues and serve as a powerful defence against shareholder discontent. And although engagement can take a variety of forms, with no "one-size-fits-all" model being appropriate, issuers that remain reluctant to engage beyond traditional annual and quarterly disclosures will find themselves falling out of step with their peers.

With these overarching themes in mind, in this edition of *Davies Governance Insights*, we shine the spotlight on the following trends and issues of particular importance in 2018, in each case offering practical insights into their impact on public companies as well as recommended best practices.

- **Shareholder proposals and proxy access**, including trends in shareholder proposals on ESG and other topics; and the tepid adoption of proxy access policies in Canada

- **Gender diversity and #MeToo**, including data and trends in women's representation on boards and executive positions; pending diversity-related amendments to the federal corporate statute; implications for companies in the #MeToo movement; and potential changes in securities law disclosure requirements

- **Virtual shareholder meetings**, including the advantages and disadvantages of virtual or virtual-hybrid meetings; the positions taken by proxy advisory firms; and issues to consider in deciding whether to go virtual

- **Climate change and sustainability**, including developments in climate change reporting, the increasing integration of social responsibility considerations into investment frameworks, growing support for climate change–related shareholder proposals; and climate expertise in the boardroom

- **Updates in shareholder activism**, including case studies and trends from this year's robust proxy contest arena; industries that are expected to remain under focus; proxy advisory firms' guidelines for campaigns on majority versus minority changes to the board; withhold campaigns as a tool for "activism lite"; and an update on "vote buying" in proxy contests

- **Director duties and implications 10 years after *BCE***, including key takeaways from the Supreme Court of Canada's decision; a discussion of the evolving definition of a "good corporate citizen"; and best practices for this new environment

- **Executive and director compensation trends and issues**, including a three-year review of CEO demographics and compensation; the evolution of "say on pay"; changes in long-term incentive plan practices; human resource experience on compensation committees; and pay ratio disclosure

- **Governance in a rapidly changing technology landscape**, including cybersecurity risk management practices; legislative updates on new mandatory breach reporting; regulatory guidelines on data protection; and blockchain enterprise opportunities

We end our review with a catalogue of other select governance developments from the past year, including updates on majority voting, the sustained demand for shareholder engagement and anti-corruption risk management.

Our corporate governance experts can help your board, committees, in-house counsel and senior management craft custom solutions to ensure your practices are aligned with current governance trends and requirements. For more information on any of the issues raised in this report or to explore how we can bring value to your board and governance teams, contact one of our experts listed under "Key Contacts" at the end of the report.

CHAPTER 01

Shareholder Proposals and Proxy Access

The year 2018 saw a continued decline in the total number of shareholder proposals, although the number of issuers receiving proposals remained fairly constant and, importantly, the number of non-financial issuers receiving proposals increased compared with previous years. Popular proposal topics in 2018 included advisory say-on-pay votes on executive compensation and pay equity; perceived deficiencies in compensation practices; climate change; and diversity policies. As we predicted last year, proxy access adoption rates proved tepid, with only eight Canadian-based TSX-listed companies, all in the financial services industry, having implemented a proxy access policy as of mid-year. We examine the reasons for the mixed market reaction to proxy access, the most significant being that the rights in these policies in many respects either duplicate those under existing regimes or are more onerous for shareholders to comply with. Within this context, we offer our predictions for the coming years and recommendations for boards to consider.

Issuers Continue to Face Proposals on Governance and Policy Issues, Albeit at a Slower Rate

Shareholders of Canadian corporations have long had the ability to use the shareholder proposal regime to submit to a corporation notice of any matter that the investor proposes to raise at a shareholders' meeting, including nominations for the election of directors. Any business validly submitted by way of a proposal must be included in the issuer's management proxy circular for its annual general meeting (AGM), subject to compliance with prescribed requirements under the applicable corporate statute. An issuer is typically not required to implement a proposal – even if approved by a majority of shareholders – but failing to do so or to at least engage with shareholders can have negative consequences if a proposal has received relatively high levels of support.

Shareholder Proposals: Top Issues and Trends in 2018

Following a surge of shareholder proposals in 2015, the number of proposals reverted to more moderate levels in 2016 and 2017. The decline continued into 2018, with this year witnessing a significantly lower number of proposals submitted to Canadian issuers (see Table 1-1). That said, the number of issuers receiving shareholder proposals has remained fairly constant year over year. And, importantly, over the past four years, we have seen that financial institutions are not the only targets of these proposals, as was historically the case. In fact, this year, the number of non-financial issuers receiving proposals increased compared with prior years.

The most common subjects of shareholder proposals in 2018 included the following:

- requiring an advisory say-on-pay vote on executive compensation, pay equity disclosure and independent compensation consultants;
- seeking corrections to perceived deficiencies in compensation policies or practices;

Over the past four years, we see that financial institutions are not the only targets of these proposals, as was historically the case – in fact, this year the number of non-financial issuers receiving proposals increased compared with prior years.

– requiring reporting and disclosure on climate change issues;
– requiring disclosure of lobbying activity;
– tax-related proposals, such as seeking to have the issuer withdraw from tax havens or jurisdictions with low tax rates;
– adopting a diversity policy and objectives with respect to female representation on the board;
– requiring separate disclosure of voting results by classes of shares and related disclosures; and
– expressing dissatisfaction with the issuer's directors and seeking cancellation of the issuer's adopted proxy access policy and implementation of the shareholder-proposed proxy access bylaw, as discussed in more detail below.

22

Number of issuers receiving proposals in 2018

16%

Average percentage of votes cast "for" (all proposals) in 2018

TABLE 1-1: NUMBER OF SHAREHOLDER PROPOSALS, ISSUERS AND AVERAGE "FOR" VOTES

	2015	2016	2017	2018
Number of proposals	65	47	46	37
Number of issuers receiving proposals	26	24	22	22
Number of financial institutions receiving proposals	7	7	7	4
Average percentage of votes cast "for" (all proposals)	19%	14%	18%	16%
Average percentage of votes cast "for" (excluding proposals approved by shareholders)	11%	7%	12%	10%

Consistent with the shareholder proposals from the prior season, the top 2018 proxy season trends include the following:

- **Climate change is top of mind.** Proposals requiring reporting on climate change issues are on the rise: this year we saw four proposals made to four separate issuers listed on the Toronto Stock Exchange (TSX), compared with three proposals made to two issuers in 2017 and two proposals made to two issuers in 2016. One of the four climate-related proposals this year, made to TransCanada Corporation, was overwhelmingly approved by the shareholders with 99% of the votes in favour. As discussed in chapter 4, Climate Change and Sustainability: Responsible Investing and Climate-Related Disclosure Gaining Traction, climate-related risk management and disclosure are increasingly being demanded of public companies.
- **Board diversity is still on the agenda.** Improving an issuer's leadership diversity is still a topic raised by shareholders by way of proposals, even though the number of such proposals has declined among TSX Composite Index and SmallCap Index issuers (eight in 2016; three in 2017; and two in 2018).
- **Two proposals received majority shareholder approval.** Two proposals put to two separate issuers received majority approval: Transat A.T. Inc., relating to comparison groups for purposes of executive compensation; and TransCanada Corporation, relating to reporting on climate change. In both cases, the proposals received overwhelming shareholder support at 92% and 99%, respectively.
- **Support levels in 2018 for proposals are consistent with four-year average.** Although most shareholder proposals typically do not achieve majority approval, shareholder support averaged 10% for the proposals that were not passed, according to data from the past four years.

Proxy Access Sees Limited Adoption in Canada

The year 2017 was hailed by some investors and commentators as the dawn of a new era in Canadian corporate governance. Following two extremely close shareholder votes, Royal Bank of Canada (RBC) and The Toronto-Dominion Bank (TD Bank) became the first two issuers in Canada to adopt proxy access policies. Some believed this development

Proposals requiring reporting on climate change issues are on the rise: this year we saw four proposals made to four separate issuers listed on the TSX.

99%

One of the four climate-related proposals this year, made to TransCanada Corporation, was overwhelmingly approved by the shareholders, with 99% of the votes in favour.

would trigger the widespread adoption of similar policies by boards across the country. Unlike the situation in the United States, however, where over 60% of S&P 500 companies have some form of proxy access in place,[1] the Canadian experience has been more limited. As of the mid-point in 2018, only eight Canadian-based TSX-listed companies – all major financial institutions – had implemented proxy access policies, with all eight policies being essentially identical. This section explores the contents of these policies and why the Canadian market response to them has been so tepid. Generally, there seems to be little incentive for other issuers to adopt similar policies at this time. Boards may be wise to wait for further clarity on potential amendments to corporate statutes, but should consider examining their director identification, selection and nomination processes in anticipation of further developments in this area.

A key reason behind the tepid reaction to TD Bank's and RBC's policies by other market participants stems from Canada's legal regime. Both the *Business Corporations Act* (Ontario) (OBCA) and the *Canada Business Corporations Act* (CBCA) already permit shareholders holding a certain percentage of voting shares (typically 5%) to submit a proposal with nominations for the election of directors to be included in management's proxy circular.[2] In addition, as discussed in our *Davies Governance Insights 2017*,[3] one or more shareholders holding not less than 5% of the issued shares of a Canadian company also have the right to requisition a meeting of an issuer to, among other things, change the directors.[4] Moreover, important differences in Canada's capital markets, compared with those in the United States, may also render proxy access less relevant or necessary for investors in Canadian public companies.

PROXY ACCESS POLICIES IN CANADA

The proxy access rights provided for in the policies of the Canadian issuers listed above in many respects either duplicate existing rights or are more onerous for shareholders to comply with. As a result, there is likely reduced incentive for many investors to advocate for such rights. Principal elements of these policies include the following:[5]

- Nominating shareholders must collectively own 5% or more of the outstanding common shares.
- Nominating shareholders must have held common shares continuously for at least three years.
- The number of director nominees may not exceed two directors or 20% of the board, whichever is greater.
- Nominating shareholders must provide representations and warranties that they acquired their shares in the ordinary course of business, and not for the purpose of influencing or changing control of the issuer.
- Nominating shareholders must provide an undertaking that they will not engage in a "solicitation" within the meaning of the *Bank Act* or securities laws other than for the sole purpose of supporting their own nominees.
- Nominating shareholders must assume all liability stemming from any action arising out of any communication by them or their nominees with the issuer.
- Nominating shareholders must also indemnify the issuer against any liability, loss or other costs incurred in connection with any threatened or pending action against the issuer arising out of the nomination notice.

As of the mid-point in 2018, only eight Canadian-based TSX-listed companies – all major financial institutions – had implemented proxy access policies.

CANADIAN ISSUERS WITH PROXY ACCESS POLICIES

– Bank of Montreal (BMO)
– Canadian Imperial Bank of Commerce (CIBC)
– Manulife Financial
– National Bank of Canada
– Royal Bank of Canada (RBC)
– Scotiabank
– Sun Life Financial
– Toronto-Dominion Bank (TD Bank)

The rights of access provided in many Canadian corporate statutes, on the other hand, do not require shareholders to provide representations, warranties or indemnities; nor do they restrict shareholders' ability to simultaneously engage in a proxy solicitation to garner support for their proposal. At the same time, existing statutory rights offer more favourable regimes to shareholders in several respects – including a six-month stock-holding period, compared with three years under the proxy access policies, and no limit on the number of nominations that can be made, in contrast to the "two-director or 20%" ceiling contained in the policies.

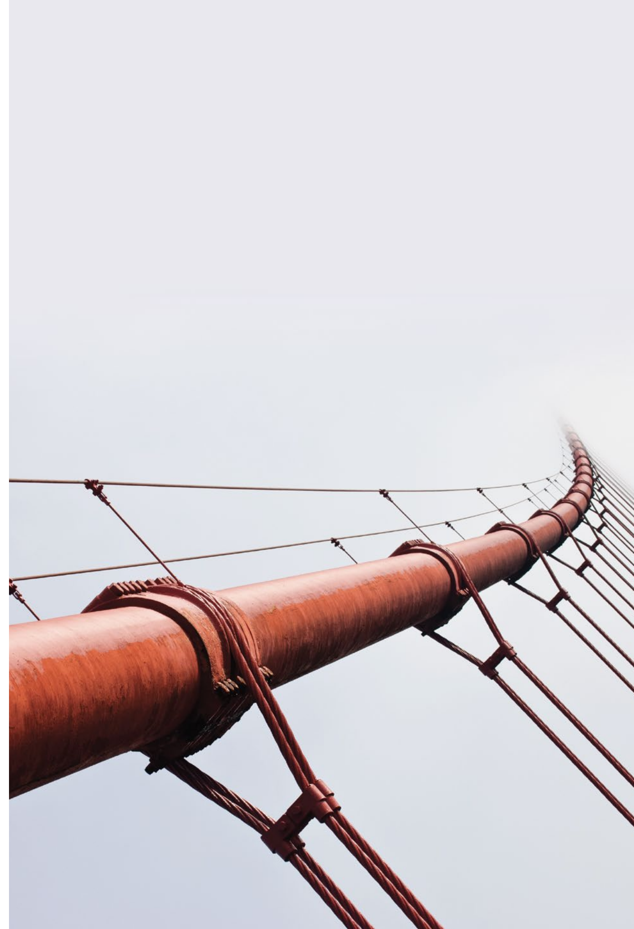
The main downside of the existing statutory rights is that there is no obligation for the issuer to include the nominees on its own proxy card or to give them any particular prominence in management's proxy circular. Previously proposed amendments to the OBCA under Ontario's Bill 101, introduced in 2017, would have changed the existing regime by requiring issuers to put a shareholder's nominees on their proxy and circular with the same prominence as management's nominees. That bill would also have reduced the minimum share ownership threshold to 3%, from 5%.[6] However, the prorogation of the Ontario Legislative Assembly in 2018 due to the provincial election resulted in Bill 101 being discontinued after passing second reading. It remains to be seen whether Ontario's new government will pursue the implementation of a form of proxy access as a statutory right under corporate law, although it has not been expressed as a top legislative priority at the time of writing this report.

MIXED MARKET REACTION TO PROXY ACCESS

Why has the Canadian market reaction to proxy access been so limited? In addition to the existing shareholder proposal and requisition regimes that make certain aspects of the RBC, TD Bank and other Canadian issuers' policies less appealing, significant debate remains over whether formal proxy access mechanisms modelled after the U.S. experience are even appropriate in the Canadian context. The combination of Canada's distinct corporate laws and the TSX rules, for example, already effectively ensure that directors can be removed and replaced by shareholders at each AGM. In addition, the smaller size of the Canadian market and greater concentration of ownership magnifies the influence of institutional investors (which are often the largest shareholders of Canadian public companies) vis-à-vis management and the board, irrespective of any formal access policies.

The policies put in place by TD Bank and RBC have received mixed reactions from advisory firms and other market participants. For example, the Canadian Coalition for Good Governance (CCGG) views these policies as too onerous on shareholders, specifically regarding the 5% share ownership requirement.[7] Glass Lewis & Co. (Glass Lewis), one of the two major proxy advisory firms, recommended that shareholders vote against both the RBC and the TD Bank policies owing to concerns over their feasibility under the *Bank Act*.[8] Institutional Shareholder Services, Inc. (ISS), on the other hand, recommended voting in favour of both policies because they would provide shareholders with a meaningful right to nominate director candidates without incurring the cost of launching a proxy contest.[9] While this latter rationale is perhaps true, a 5% ownership threshold translates to approximately $7 billion of holdings in the case of each bank. Any shareholders able to utilize the access right on the basis of this ownership threshold likely already wield significant influence over, and have input into, the nomination and election of directors. Less passive shareholders invested at that quantum are also not likely to be dissuaded solely by the expense of a full-fledged proxy contest if they perceive real failures in the governance of the issuer.

Some shareholders have chosen to take the route of the shareholder proposal mechanism to express dissatisfaction with the manner in which proxy access has been adopted. In the case of at least one of the Canadian banks that implemented a proxy access policy, a shareholder submitted a proposal claiming that the parameters of the policy as adopted were significantly different from, and less advantageous to shareholders than, the 2017 versions originally proposed, and that the proxy access policy should therefore be cancelled and resubmitted to a shareholder vote in the form of a bylaw. Some of the differences cited were the 5% ownership threshold (contrasted with 3% as preferred by some stakeholders). The bank's response was that



the 5% threshold is a requirement under the *Bank Act* and that legislative proposals to change the threshold to 3% have been submitted to the Department of Finance. The shareholder proponent also took issue with the cap on the number of shareholder nominees permitted under the proxy access policy (20% of the board size instead of 25%). The bank's response was that 20% is the prevailing U.S. practice and accepted by CCGG as "necessary to avoid 'creeping board control' through the proxy access mechanism."[10] This shareholder proposal failed, having received only 1.4% of the votes cast.

The policies put in place by TD Bank and RBC have received mixed reactions from advisory firms and other market participants.

Our Take: Review Your Director Appointment Processes

At this time, given the unique aspects of the Canadian market and legal regime, it remains questionable whether proxy access policies or bylaws (whether similar to the typical U.S.-style bylaw or the few Canadian-style policies that have emerged) offer any material enhancement to shareholder rights over existing mechanisms. For this reason, and consistent with our predictions last year, we do not expect widespread adoption of proxy access across Canada in the near term. Nonetheless, proxy access will remain on the radar of many institutional investors during the 2019 proxy season and beyond.

We expect that over the coming years, larger issuers, particularly those in the financial services industry, are likely to face pressure to meaningfully enhance shareholder rights in some form or another, whether through proxy access or some other means.

Boards of Canadian issuers in other industries should still consider whether proxy access or some of its alternatives may be appropriate in their circumstances. We recommend that boards consider the relevance of proxy access within the context of their existing policies and

We expect TSX-listed issuers will face continued pressure to increase shareholders' input into, and greater transparency over, issuers' director identification, selection and nomination processes, and the relative skills and competencies each director brings to the board.

practices, having regard to a multitude of factors. These factors include the nature of their shareholder engagement policies (if any), the practices implemented by industry peers, their market capitalization and share structure, the views of their significant shareholders, and the skills and competencies of their board members in light of their long-term strategies and plans. While 2017 may not have quite marked the opening of the proxy access floodgates, it exemplified the continued trend of growing shareholder engagement and interest in corporate governance matters. Short of proxy access, we expect that TSX-listed issuers will face continued pressure to increase shareholders' input into, and greater transparency over, issuers' director identification, selection and nomination processes, and the relative skills and competencies each director brings to the board. We also expect that issuers may find themselves under pressure (whether as a formal requirement or an advocated best practice) to formalize and provide greater disclosure concerning their processes for identifying, selecting and nominating directors, including articulating how shareholders may have input into the process.

Looking Through the Gender Lens: Diversity and Harassment in the Era of #MeToo

Year over year, many issuers are making progress in improving gender diversity among their corporate leadership, with some industries such as REITs taking the lead. However, progress remains slow. With proposed diversity-related amendments to the CBCA expected over the next two years, and Canadian securities regulatory authorities focusing on additional measures to enhance public companies' disclosure and practices in this area, we expect that further changes will be forthcoming. In addition to regulatory and policy changes, progress is also being driven by issuers, proxy advisory firms and institutional investors. For example, New York Pension Funds are targeting major U.S. public companies to improve the diversity of their leadership. Beyond diversity, broad movements such as #MeToo and #TimesUp are creating new challenges and risks in the area of sexual harassment, a serious issue confronted by North American corporations that many boards have yet to turn their attention to. Here is our take on what boards should do to address sexual harassment risks and continue to advance the diversity of their organizations.

Update on Gender Diversity and Trends: Progress Continues

We have continued to track developments in gender diversity disclosure since the 2015 implementation by the Ontario Securities Commission (OSC) of the comply-or-explain disclosure requirements under National Instrument 58-101 – *Disclosure of Corporate Governance Practices* (NI 58-101). Our prior editions of *Davies Governance Insights*[11] detail extensive data and analysis on issuers' progress toward meeting various diversity measures. As Tables 2-1, 2-2 and 2-3 demonstrate, progress continues to be moving steadily in a positive direction, although at a slow rate. Given that boards, by design, tend not to have high volume turnovers within short periods of time, meaningful progress will take time.

TABLE 2-1: DIVERSITY PROGRESS 2014–2018

	2014	2015	2016	2017	2018
Board seats of TSX Composite and SmallCap Index issuers held by women	12.3%	15.1%	17.7%	19.2%	20.8%
Board seats of TSX 60 issuers held by women	20.1%	23.1%	24.6%	26.3%	27.5%
TSX Composite and SmallCap Index issuers with written diversity policies	8.6%	37.1%	48.0%	51.3%	61.3%
TSX Composite and SmallCap Index issuers with female board chairs	3.2%	3.8%	4.4%	4.3%	5.2%
TSX Composite and SmallCap Index issuers with targets	3.2%	11.1%	16.1%	18.7%	24.5%
TSX 60 issuers with targets	10.0%	28.3%	35.0%	46.7%	48.3%
Newly elected women directors on TSX Composite and SmallCap Index issuers	–†	26.2%	24.8%	24.1%	27.8%

†Note: Comparative data is not available for the 2014 proxy season.

TABLE 2-2: ISSUERS THAT PUT FORWARD ONE, TWO OR NO FEMALE DIRECTORS

	2015	2016	2017	2018
TSX Composite and SmallCap issuers that put forward at least one woman for election to the board	68.1%	76.6%	80.2%	86.6%
TSX Composite and SmallCap issuers that put forward at least two women for election to the board	37.1%	44.4%	47.6%	50.8%
TSX Composite and SmallCap issuers that put no women forward for election to the board	31.9%	23.4%	19.8%	13.4%

Assuming the board fill rate increases to 50% women over time, it will take over 30 years to get parity between men and women on TSX boards.

38%

of non-venture issuers included in the CSA review still have no women in executive officer positions.

In the fall of 2017, the Canadian Securities Administrators (CSA) reported on the results of its third annual staff review of women on boards and executive officer positions, followed by a roundtable discussion on October 24, 2017, to discuss these results.[12] In addition to other data points such as board representation, executive offices, policies, targets and compliance, this year the CSA also reported on a new statistic: board vacancies filled by women. According to the study sample, 674 board seats were vacated and 505 of those seats were filled. Of the vacancies filled, 26% (131 seats) were filled by women and 74% (374 seats) by men.[13] On the basis of these findings, assuming the board fill rate increases to 50% women over time, it will take over 30 years to get parity between men and women on TSX boards.[14]

The CSA review also reveals that the progress with respect to women executives is even slower than that among directors. We note that 38% of non-venture issuers included in the CSA review still have no women in executive officer positions, which is only down 2% from the CSA's 2015 review. See Table 2-3 for details.[15]

TABLE 2-3: NON-VENTURE ISSUERS WITH WOMEN IN EXECUTIVE OFFICER POSITIONS

	2015	2016	2017
Non-venture issuers with at least one woman in an executive office position	60%	59%	62%
Non-venture issuers with at least two women in executive office positions	30%	31%	32%
Non-venture issuers with at least three women in executive office positions	15%	16%	16%
Non-venture issuers with no women in executive office positions	40%	41%	38%

Source: CSA Multilateral Staff Notice 58-309 – *Staff Review of Women on Boards and in Executive Officer Positions – Compliance with NI 58-101 Disclosure of Corporate Governance Practices* (October 5, 2017)

Progress in increasing female representation in board and executive officer positions continues to vary across industries. The retail industry was reported to have the greatest percentage of issuers with one or more women on their boards, whereas the mining, oil and gas, and technology issuers ranked among the lowest on the same metric. Similarly, the oil and gas industry has the lowest percentage of issuers with one or more women holding executive officer positions, whereas the real estate and manufacturing industries rank the highest.[16]

Given the slow pace of improvement noted by securities regulators and concerns articulated by other market participants, we expect that the CSA will continue to investigate ways to incentivize issuers to improve their diversity-related practices. In our view, changes could come in the following areas:

- Issuers may be required to disclose the number and percentage of women on boards and in executive positions in tabular format, potentially including data for a period of more than one year.
- Issuers may face greater pressure to include a skills matrix in their proxy circulars, identifying the skills and competencies required of their board and how those requirements tie into the director identification, selection and nomination process (skills matrices are also discussed further below).
- National Policy 58-201 – *Corporate Governance Guidelines* (NP 58-201) may be expanded to include additional best practices regarding processes and policies for identifying, selecting and nominating diverse board candidates.

Given the slow pace of improvement noted by securities regulators and concerns articulated by other market participants, we expect that the CSA will continue to investigate ways to incentivize issuers to improve their diversity-related practices.

Whatever steps the regulators pursue next, issuers should expect that absent a meaningful rise in the number of women on boards and in executive positions among TSX-listed companies, additional regulation will be forthcoming.

Update on Proposed CBCA and OBCA Amendments

In our *Davies Governance Insights 2016*, we discussed the federal government's proposed amendments to the *Canada Business Corporations Act* (CBCA) and related regulations that would require CBCA public corporations to provide prescribed information in respect of diversity among directors and senior management to its shareholders at every annual meeting. After a nearly two-year battle, the proposed CBCA amendments, embodied in Bill C-25, received royal assent on May 1, 2018.

The proposed amendments to the CBCA and related regulations indicate that the prescribed diversity information required to be disclosed is the same information required by items 10 to 15 of Form 58-101F1 under NI 58-101, including disclosure regarding director term limits and other mechanisms of board renewal, policies relating to the identification and selection of female directors, consideration given to women in director and executive identification, selection and appointments, gender targets for boards and executives and the number of women on boards and in executive positions. However, the CBCA amendments go beyond gender. The disclosure must include all designated groups as defined by the *Employment Equity Act* (i.e., women, Aboriginal peoples, persons with disabilities and visible minorities).[19] The proposed amendments to the CBCA regulations are expected to be finalized in the next 18–24 months, which would require CBCA public corporations to comply with these disclosure requirements in the 2020 or 2021 proxy season. In the meantime, market participants can provide comments to Corporations Canada.[20]

While the CBCA diversity requirements have been given life, similar changes proposed to the *Business Corporations Act* (Ontario) (OBCA) under Bill 101 have met the opposite fate. On May 8, 2018, the 41st Parliament of Ontario was dissolved. As a result, any bills that had not received royal assent before that day were discontinued. Given that the amendments were successful at the federal level but failed at the provincial level, a gap in the approach to diversity disclosure will exist once Bill C-25 is in force. For the OBCA to be aligned with the CBCA on the issue of diversity disclosure, a new bill will need to be introduced and passed by the newly elected Progressive Conservative government. Although the new Ontario government called back the Ontario Legislative Assembly for a rare sitting this summer, amendments to the OBCA were not among the priorities during that session. It remains to be seen whether OBCA amendments will be revived during the regular 2018-2019 sitting.

REITS TAKE THE LEAD IN THE RACE TO GENDER PARITY ON BOARDS

During the 2018 spring proxy season, the traditionally male-dominated real estate investment trust (REIT) sector named a record number of women to board positions, with 52% of newly elected directors being women.[17] Two factors are contributing to the spike in female appointments: first, as Bill Ferguson of Ferguson Partners, which released the study, says, it's the realization that having women on the board is a "huge value-add"; and, second, large institutional investors are saying they will vote against corporate boards without female directors.

Like many other industries, this progress is promising; however, REITs still have a long way to go to achieve meaningful gender parity. Overall, only eight REITs currently have female chief executives, and just 17.5% of all directors are women.[18]

In Focus: Are You Prepared for Allegations of Sexual Assault?

Should a company be required to disclose allegations of sexual misconduct to its shareholders and, if so, when?

Allegations of sexual assault against Steve Wynn, now former chairman and CEO of Wynn Resorts, sent the casino and resort company's stock tumbling.[21] Wynn's resignation came less than two weeks after the *Wall Street Journal* reported that a number of women alleged that Wynn harassed or sexually assaulted them, and that one case led to a US$7.5-million settlement.

Although Wynn denied all allegations, the Associated Press reported that the company's stock has fallen almost 12% since the *Wall Street Journal*'s January 26, 2018 report.[22] This incident, and many others like it, raises the question: Should a company be required to disclose allegations of sexual misconduct to its shareholders and, if so, when?

While there are currently no specific laws requiring companies to disclose internal allegations of sexual harassment or settlements involving employment-related complaints, public companies are required to disclose legal proceedings and regulatory actions that meet certain thresholds. In addition, stock exchange rules and securities laws require Canadian public companies to promptly disclose any material fact, which is generally any fact that significantly affects the market price or value of a security or would reasonably be expected to have a significant effect on the market price or value of a security. Materiality is a question of fact and will depend on a number of factors in each case. According to the CSA, events or information that may be material include any development that affects the company's resources, technology, products or markets, changes to the board of directors or executive management, including departures of a CEO, CFO, COO or president, the commencement of or developments in material legal proceedings or regulatory matters, and waivers of corporate ethics and conduct rules.[23] One or more of these events may arise in the context of an allegation of sexual misconduct against a senior leader of a public company.

Take the Wynn case as an example. Jeffrey Sonnenfeld, a professor at the Yale School of Management, believes the Wynn incidents should have been disclosed to Wynn Resorts' shareholders: "It's not just his choice, his decision, but also his name and even his signature, so it's hard to disentangle the value of his personal conduct and image with the brand value."[24] The Associated Press

reported that at least one shareholder, Norfolk County Retirement, raised these factors in a lawsuit filed in the Nevada District Court against Wynn Resorts and claimed that the board of directors breached its fiduciary duties by "turning a blind eye and disregarding a sustained pattern of sexual harassment and egregious misconduct by Mr. Wynn."[25]

The global #MeToo movement against sexual harassment and assault, which spread virally in October 2017, has promoted an increase in the reporting of allegations of sexual misconduct and magnified their impact. Through the use of proposals, proxy battles and the press, shareholders have also made it clear that actions to tackle sexual harassment and assault, as revealed through the 2018 #TimesUp campaign, are looming around the corner. Some investors believe increasing gender representation and pay equity will help reduce future problems of this nature; others say that public accountability will force companies to progress at a faster pace.[26]

The Wynn Resorts example is just one of many allegations of sexual misconduct that have caused serious repercussions in the entertainment and business communities. Despite these trends, a 2017 survey conducted by the U.S.-based organization "theBoardlist," together with data analytics firm Qualtrics, of more than 400 directors and venture capitalists in the United States found that 77% of boards had not talked about sexual harassment, 88% had not implemented a plan of action as a result of revelations resulting from the then-recent harassment allegations against leaders in Silicon Valley and Fox News, and 83% had not evaluated the company's risks regarding sexual harassment.[27] This is in spite of statistics showing that in Canada, over one-third of Canadian women surveyed in 2018 reportedly said they had been sexually harassed at work.[28] A *Wall Street Journal*/NBC 2017 poll in the United States found that 48% of employed women said they had faced an unwelcome sexual advance or other verbal or physical harassment of a sexual nature at work, and 41% of respondent employed men said they had witnessed a woman face an unwelcome sexual advance.[29] In Canada, at least eight Canadian issuers have faced public sexual harassment allegations over the past three years. In the United States, over 62 publicized allegations have been made against S&P 500 companies in 2017 alone, up from 27 in 2016.[30]

In a climate in which environmental, social and governance issues are of increasing importance to investors, and with victims feeling more comfortable coming forward, boards and senior management must avoid the common misperception that "it's not a problem here." Allegations of sexual misconduct typically come as a complete surprise and have resulted in major damages or settlements, the loss of key leaders, plunging stock prices and long-term challenges with workplace culture and productivity, as well as a negative effect on companies' ability to attract and retain talent. Allegations may also be perceived by investors as symptomatic of a company's failure to have robust governance structures in place, including a lack of commitment to improve leadership diversity. Under Canadian and provincial laws, employers are responsible for harassment committed by their employees. Businesses that have not yet assessed their workplace culture and taken steps to ensure they have clear, robust and appropriate sexual harassment policies would be well advised to do so.

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Proxy Advisory Services Are Pushing for More Change

In its 2018 proxy voting guidance for Canada, Institutional Shareholder Services, Inc. (ISS) stated that it will recommend that shareholders "withhold" votes for the chair of the nominating committee or equivalent (or the chair of the board of directors if no nominating committee has been identified) if the company has no female directors on the board and has not disclosed a formal written gender diversity policy.[31] ISS indicates that a company's formal written gender diversity policy should provide a short summary of its objectives and key provisions, describe the measures taken to ensure that the policy has been effectively implemented, disclose annual and cumulative progress by the company in achieving the objectives of the policy and disclose how the board or its nominating committee measures the effectiveness of the policy. In addition, under the ISS guidelines the gender diversity policy must include a clear commitment to increase board gender diversity. ISS has stated that boilerplate or contradictory language in a company's gender diversity policy may result in withhold recommendations from ISS for directors.

When determining a company's commitment to board gender diversity, ISS will also consider the board's disclosed approach to gender diversity in executive officer positions and stated goals or targets, or programs and processes for advancing women in executive officer roles, and how the success of such programs and processes is monitored.

ISS's policy does not apply to public companies newly listed within the current or prior fiscal year, companies that have transitioned from the TSXV within the current or prior fiscal year, or those that have four or fewer directors. For the 2018 season, ISS's policy applies only to Composite Index issuers; starting in 2019, it will apply to all TSX-listed issuers.

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Glass Lewis & Co. (Glass Lewis) stated in its 2018 proxy voting guidance for Canada that it will not make voting recommendations solely on the basis of the diversity of the board; rather, diversity will be one of many factors considered when evaluating a company's oversight structure.[32] However, beginning in 2019, Glass Lewis will generally recommend voting against the nominating committee chair of a board that has no female members or that has not adopted a formal written gender diversity policy. Depending on other factors, including the size of the company, the industry in which the company operates and the governance profile of the company, Glass Lewis may extend this recommendation to other nominating committee members. Glass Lewis indicates that in making its voting recommendations, it will carefully review a company's disclosure of its diversity considerations and may refrain from recommending that shareholders vote against directors of companies outside the Composite Index, or when boards have provided sufficient rationale for the absence of female board members or have disclosed a plan to address the lack of diversity on the board.

Securities Regulators Are Looking for Answers

On February 23, 2018, the British Columbia Securities Commission (BCSC) requested public comment on potential modifications to NI 58-101 regarding the

representation of women on boards and in executive positions (Disclosure Requirements). Although the BCSC has not yet signed on to the comply-or-explain regime, it has indicated that it wants to provide the opportunity for British Columbia market participants affected by the legislation of the participating jurisdictions to have a say in this regulatory development.[33]

The BCSC requested input on issuers' experiences and challenges with the Disclosure Requirements: whether they are providing investors with beneficial information and whether more specific guidelines on the disclosure and nomination processes would be useful, among other related topics.

The comment period closed on April 10, 2018. The BCSC indicated in its initial request for comment that it did not anticipate publishing the comments received. However, some investor groups have released their comments separately, including the Pension Investment Association of Canada, British Columbia Investment Management Corporation, Alberta Investment Management Corporation, Canadian Coalition for Good Governance and NEI Investments.

Common themes advanced by these groups include the following:

- The BCSC should adopt the Disclosure Requirements.
- Gender diversity is an important issue that shareholders care about and the information received as a result of the Disclosure Requirements is valuable.
- Some investor groups are already using proxy voting guidelines to take a stand against the lack of board diversity.[34]

Several groups also expressed the view that the current guidelines were not prescriptive enough, although they found it difficult to articulate the appropriate balance between the rigidity needed to ensure compliance and advancement, and the flexibility to allow for creativity and inclusion of other forms of diversity – an issue that we are aware the OSC and other participating jurisdictions continue to struggle with.

THE 30% CLUB: HAVE YOU CONSIDERED OPTING IN?

While the regulators are considering whether further regulation and disclosure is needed to increase female representation on boards and in executive positions, the 30% Club Canada is encouraging board chairs and CEOs to opt in to the aspirational target of 30% of board seats and C-suites to be held by women by 2022.[35]

The 30% Club was launched in the United Kingdom in 2010 with the goal of achieving a minimum of 30% women on FTSE-100 boards. In addition to tracking progress toward the voluntary opt-in 30% target, the 30% Club runs a number of specific and targeted initiatives that look to broaden the pipeline of women at all levels, from "the schoolroom to the boardroom." Like many other market participants, the 30% Club does not believe mandatory quotas are the right approach.

The 30% Club Canadian Investor Group Statement from September 2017 includes a "call to action," which recommends that companies

- publicly disclose their diversity policies and the processes used to identify female candidates for the board and executive management positions;
- adopt a professional and structured approach to director nominations that ensures directors are appointed on the basis of merit, with due regard for the benefits of gender diversity;
- use existing resources and tools to ensure effective consideration of gender diversity and recognize and take steps to mitigate cognitive bias wherever possible; and
- commit to rigorous assessment of director and executive performance, as well as regular board refreshment.[36]

Sixteen investors, managing a combined $2.1 trillion in net assets, currently publicly support the 30% Club Canadian Investor Group Statement.[37]

BEYOND COMPLY-OR-EXPLAIN: DELL BRINGS LASER FOCUS TO BUSINESS WOMEN'S STRENGTH AND POWER

Although many view the progress in increasing female representation among public company boards and executives as being too glacial, metrics are not the sole measure of the advances being made to promote gender parity. **This year, Dell held its 9th annual Dell Women's Entrepreneur Network (DWEN) Summit over two and a half days in Toronto, bringing together approximately 200 inspiring female entrepreneurs from around the globe.** Dell has shown significant commitment to accelerating the increasingly powerful role that women play in driving global economic growth. Through DWEN, Dell connects women entrepreneurs with networks, sources of capital, knowledge and technology – giving them the power to do more. The event has grown into a thriving international network with hundreds of female business owners who connect throughout the year to share their knowledge and support their peers in accelerating business growth.

The DWEN Summit highlighted some of the headway being made in Canada – the federal government is pushing for change through its $2-billion Women Entrepreneurship Strategy. Among other features, the Strategy, which was announced as part of the 2018 federal budget, will provide $1.4 billion over three years in financing for female entrepreneurs through the Business Development Bank of Canada; $10 million over five years to connect women with expanded export services and opportunities; $200 million for investments in women-led technology firms; $10 million over five years to connect women with expanded export services; and $9.5 million over three years for proposals on collecting gender-based data on entrepreneurs. In an economy in which women represent half of the population and are responsible for a significant majority of consumer spending decisions, investing in women is not only the right thing to do, but also critical to growing Canada's economy and competitive position.

Another venture highlighted at the DWEN Summit featured Sally Krawcheck, CEO and co-founder of Ellevest, a digital financial adviser for women launched in 2016. She is also the chair of Ellevate Network, a global professional women's network, and of the Pax Ellevate Global Women's Index Fund, which invests in the top-rated companies in the world for advancing women. Before becoming an entrepreneur, she was CEO of Merrill Lynch Wealth Management, of Smith Barney and of Sanford Bernstein. Through Ellevest, Krawcheck has co-founded a unique investment firm aimed at fulfilling the investment needs of women, while also investing their capital using a gender lens.

Research presented by Dell at the Summit suggests that female-founded startups outperform male-founded startups. Among other benefits, which are consistent with the outperformance many cite for public companies that have more diverse leadership teams, female-founded startups return $0.787 more on the dollar compared with their male counterparts at $0.31; produce $85 million in additional venture capital potential over five years; and generate 10% more in cumulative revenue over a five-year period.

Dell's commitment and its female entrepreneurs' business initiatives, combined with many other industry, governmental and market efforts aimed at improving gender diversity and equity, provide a more positive picture of the significant strides being made in an effort to support and promote women. They also highlight the need for multi-pronged strategies and commitments by both men and women, including a wide range of market participants, if meaningful change is to occur.

N.Y. Comptrollers DiNapoli and Stringer see diversity as a strategy for economic success and expect that increased transparency will lead to more diverse boards.

No other Canadian securities commissions have publicly sought comment on amending NI 58-101 or NP 58-201. However, the BCSC's request for comment indicated that each participating jurisdiction would be consulting locally, resulting in an ongoing discussion with interested stakeholders about ways to promote greater progress in the representation of women among Canadian public companies at the national level.

Best Practices Beyond Gender: Skills Matrix Inspiration from New York Pension Funds

Consistent with the Canadian landscape, progress in the United States in improving gender diversity among the leadership of public companies also remains slow. According to ISS, in 2017, only 22% of directors of S&P 500 companies were female – up from 16% in 2008.[38]

Pension funds in the United States have served a critical role in advancing the diversity of the boards of public companies. Two leading voices on the issue are those of New York State Comptroller Thomas P. DiNapoli, who oversees New York State's Common Retirement Fund, valued at over US$200 billion, and New York City Comptroller Scott Stringer, who oversees New York City's five pension funds, valued at over US$160 billion. DiNapoli and Stringer see diversity as a strategy for economic success and expect that increased transparency will lead to more diverse boards. DiNapoli announced earlier this year that the New York State Common Retirement Fund would vote against all directors standing for re-election to boards that do not include any women. In 2017, Stringer and the New York City pension funds launched a "National Boardroom Accountability Project Campaign Version 2.0," which calls on boards to disclose the race, gender and skills of their directors in a standardized matrix format and to enter into a dialogue regarding their boards' refreshment processes.[39] The matrix would require companies to identify each director's experience and competence in a wide variety of areas, consistent with many existing matrices used by Canadian public companies; however, it would also require information to be disclosed in respect of each director's tenure, sexual orientation (voluntary), gender (male, female or non-binary), age, race and ethnicity.

We believe much of this disclosure would be welcomed by investors. Currently under U.S. securities laws, companies need disclose only certain generic diversity metrics, including whether and how nominating committees consider diversity, how their diversity policies are implemented and how they assess the effectiveness of such policies, if they exist. In 2017, the U.S. Securities and Exchange Commission (SEC) Advisory Committee on Small and Emerging Companies recommended that U.S. public companies be required to disclose the extent to which their boards are diverse; however, the SEC has not taken up this recommendation to date.[40]

As we discussed in prior *Davies Governance Insights* reports, N.Y. City Comptroller Stringer's initial Boardroom Accountability Project launched in 2014 was highly successful in getting many U.S. public companies to adopt proxy access, resulting in more than 60% of S&P 500 companies now having some form of proxy access. As part of the new Version 2.0 Project, Comptroller Stringer and the NYC Pension Funds are calling on the boards of 151 U.S. companies to disclose the race and gender of their directors, along with board members' skills in the standardized matrix format, and to enter into a dialogue regarding their boards' refreshment processes. We are also aware of shareholder proposals that have been submitted by the N.Y. State Common Retirement Fund, resulting in meaningful changes by some U.S. companies in their disclosure and director selection processes, in order to ensure greater diversity of candidates are considered for board appointments.

Our Take: What Should You Do This Year to Improve Your Organization's Governance Practices?

Many of our recommendations from past Davies Governance Insights editions continue to be relevant; however, the three best practices outlined below are especially worth considering this year.

1 Develop More Meaningful Diversity Disclosure (Beyond Gender)

We, and Canada's securities regulators, continue to believe that meaningful disclosure will improve the pace of progress in advancing women in leadership roles. In addition, given the CBCA amendments and recent trends in New York, it may be worthwhile for companies (even those governed by corporate statutes other than the CBCA) to start considering incorporating diversity disclosure beyond gender into their policies and practices.

One way to improve the quality of disclosure is to adopt diversity criteria into your board skills matrix. As discussed above, the NYC Pension Funds' Version 2.0 Project posted online a sample skills matrix that includes diversity criteria.[41] A skills matrix developed with regard to the company's medium- and long-term strategies and plans not only helps ensure the board possesses the necessary skills, experiences, diversity and competencies needed to maximize its effectiveness, but also serves as a useful guidepost when identifying potential candidates for board refreshment in the future. Issuers should also review the annual diversity-related disclosures in their proxy circulars, and identify ways to improve the meaningfulness and transparency of that disclosure, rather than simply providing boilerplate statements.

2 Use Selection and Succession Planning

In addition to developing more meaningful disclosure, boards should turn their minds to utilizing selection and succession planning to achieve diversity goals. We encourage boards to dedicate time to consider and create a formalized process for director and executive identification, selection and appointment that recognizes the unconscious biases inherent in these processes. For example, consider how candidates will be sourced, including by identifying traditional and non-traditional networks from which capable persons having a range of relevant skills may be selected. Consider also whether certain targets (e.g., at least 50% of female candidates) will be required as part of any search process. It is also worthwhile to consider using an outside adviser and providing a clear breakdown of your diversity objectives and skills requirements, so a relevant and responsive policy can be crafted to meet your specific needs.

3 Adopt a Stand-Alone Sexual Misconduct Policy

Most Canadian and U.S. public companies do not have stand-alone sexual harassment policies; nor have their boards discussed the issue within their organizations. In light of the growing publicity surrounding allegations of sexual harassment, as well as an emerging climate that promotes reporting of all forms of sexual harassment, we recommend that boards charge their senior management, including (but not limited to) their HR executives, with reviewing and evaluating their organizations' current policies and processes relating to sexual harassment. Although many existing workplace harassment policies will already reference sexual harassment, given the specialized and highly sensitive aspects of sexual harassment complaints, having a stand-alone policy and process is our recommended best practice. The policy should address the following, among other things:

- what constitutes "sexual harassment" (remembering that legal definitions of sexual harassment may fall short of the full range of undesirable behaviour that can cause significant reputational and financial damage to your company);
- the persons responsible for overseeing and enforcing the policy;
- a procedure for reporting, handling and investigating incidents and maintaining confidentiality; and
- the consequences of a substantiated violation of the policy.

As part of boards' overall responsibility for risk management, they should task management with reporting back to them on the workplace culture and the steps being taken to prevent sexual misconduct, and respond swiftly and appropriately in the event a complaint emerges. We also recommend that appropriate training, in line with an established sexual harassment policy, be provided to all employees, including specialized training for those charged with principal responsibility for administering and enforcing the policy.

Virtual Shareholder Meetings Generate Growing Interest

Directors and officers of many Canadian public companies are considering whether to adopt a virtual format for their companies' shareholder meetings. With the increasing popularity of virtual shareholder meetings in the United States, a corporate landscape that favours innovative technologies, and demonstrable efficiencies associated with "going virtual," virtual meetings are generating growing interest among issuers and their shareholders. However, in light of some of the risks and disadvantages associated with virtual-only meetings, to date, Canadian public companies opting for virtual meetings have tended to gravitate toward a hybrid-virtual format.

Hybrid-virtual meetings are expected to be on the rise, while virtual-only formats will continue to attract scrutiny from proxy advisory firms and institutional investors.

Reliable remote meeting technology now allows issuers to conduct shareholder meetings virtually, giving participants the ability to view and/or participate in meetings via an online portal through which they can vote and ask questions. The adoption of the virtual meeting format, particularly for non-contentious annual general meetings (AGMs), is an emerging trend in Canada and abroad, and one that we expect will continue to gain traction to varying degrees.

There are two principal types of virtual shareholder meetings: (i) hybrid-virtual meetings and (ii) virtual-only meetings. Hybrid-virtual meetings are traditional physical meetings that are supplemented by an electronic participation component whereby shareholders can hear – and sometimes view – the meeting proceedings in real time, as well as ask questions and vote online contemporaneously. Virtual-only meetings, conversely, do not give shareholders the option to attend a physical meeting; accessing an online portal is the sole means available to attend, ask questions and vote at the meeting.

References to "virtual meetings" in this chapter refer to both hybrid-virtual and virtual-only meetings.

Virtual Meeting Requirements under Canadian Law

The *Canada Business Corporations Act* (CBCA) has facilitated the adoption of virtual meetings by federally incorporated corporations since 2001. The CBCA stipulates only two requirements for a Canadian corporation to host a virtual meeting:

1. The corporation's bylaws must allow for virtual shareholder meetings.
2. The virtual means used to enable the meeting must permit all participants to communicate adequately with each other during the meeting.[42]

While there are practical pros and cons to holding virtual meetings, as discussed further below, there are no other specific corporate law requirements governing virtual meetings by a CBCA corporation. Most provincial corporate statutes also permit virtual meetings, with legal requirements similar to, or less onerous than, those of the CBCA.[43] For example, the *Business Corporations Act* (Ontario) (OBCA) permits virtual meetings by Ontario corporations. Unlike the CBCA, the OBCA does not require a corporation's bylaws to expressly permit virtual meetings; rather, they must simply not explicitly prohibit them.

An example of a fairly typical bylaw provision permitting virtual meetings is as follows:

"Meeting by Electronic Means: A meeting of the shareholders may be held by telephonic or electronic means and a shareholder who, through those means, votes at the meeting or establishes a communications link to the meeting shall be deemed for the purposes of the Act to be present at the meeting. A meeting held by telephonic or electronic means shall be deemed to be held at the place where the registered office of the Corporation is located."[44]

Virtual Meetings Emerging in Canada

U.S. COMPANIES THAT ARE CANADIAN REPORTING ISSUERS

The first large-cap reporting issuer in Canada to hold a virtual-only meeting was Lululemon Athletica Inc. in 2016. Lululemon, whose head office is in Vancouver, British Columbia, is a Delaware company listed on the Nasdaq and a reporting issuer in all provinces and territories of Canada. Lululemon has since continued to hold virtual-only AGMs, with its most recent meeting held in June 2018. Since 2016, other U.S.-based companies that are also reporting issuers in Canada have held virtual-only

meetings, including TearLab Corporation (a Delaware company listed on the Toronto Stock Exchange (TSX), which is a reporting issuer in all Canadian provinces); and Mirati Therapeutics, Inc. (a Delaware company listed on the Nasdaq and a reporting issuer in all Canadian provinces). Others include Lumentum Holdings Inc. (a Delaware company listed on the Nasdaq and a reporting issuer in Québec); CohBar, Inc. (a Delaware company listed on the TSX Venture Exchange (TSXV) and a reporting issuer in all Canadian provinces); and NovaBay Pharmaceuticals, Inc. (a Delaware company listed on the AMEX and a reporting issuer in British Columbia, Alberta, Manitoba and Ontario).

VIRTUAL-ONLY MEETINGS BY CANADIAN PUBLIC COMPANIES

The only reporting issuer established under Canadian law to have held a virtual-only meeting was Concordia International Corp. in June 2017. Concordia hosted its virtual-only meeting with the assistance of TSX Trust Company, a subsidiary of TMX Group Limited, as its registrar and transfer agent. Concordia also collaborated with Lumi, a company that specializes in shareholder meeting technology, to implement audiovisual streaming technology, secured attendance authentication and real-time voting tabulation.

HYBRID-VIRTUAL MEETINGS IN CANADA

Canadian corporations have recently begun adopting the hybrid-virtual meeting format, including four large-cap issuers: Goldcorp Inc., Barrick Gold Corporation, TMX Group Limited and OceanaGold Corporation. As did Concordia, each of these four corporations collaborated with Lumi to provide the online platform. For Barrick, TMX Group and Oceana, 2018 was the first year they adopted a virtual meeting format.

ADVISORY VOTE ON GOING VIRTUAL

For the first time in Canada, in 2018 an issuer asked its shareholders to vote on whether it should adopt a virtual meeting format. At the May 2018 AGM of SSR Mining Inc., a Vancouver-based company with shares dual-listed on the TSX and the Nasdaq, its shareholders voted in a non-binding advisory capacity on whether to approve a resolution authorizing SSR to adopt a virtual-only format for its 2019 AGM. In its corresponding management information circular, SSR stated that its

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principal objective for adopting a virtual-only meeting was to increase shareholder access and engagement while reducing attendance costs and disruption. The advisory vote failed by a significant margin, with less than 22% of SSR shareholders voting in favour of the proposal.

Virtual Meetings in the United States

In the United States, virtual meetings are significantly more prevalent and are becoming increasingly normalized. There are many large-cap and high-profile U.S. companies that have moved to a virtual-only meeting format, including 23 Fortune 500 companies, such as Ford Motor Company, Duke Energy Corporation, HP Inc., Intel Corporation, PayPal Holdings, Inc., Netflix, Inc., and Best Buy Co., Inc.

Broadridge Financial Solutions, Inc. (Broadridge) is the provider of remote meeting technology and services that assists most U.S. public companies with their virtual meetings. According to data from Broadridge, four U.S. issuers held virtual AGMs in 2009; 134 U.S. issuers held virtual AGMs in 2015; 187 U.S. issuers held virtual AGMs in 2016; and 236 U.S. issuers held virtual AGMs in 2017.[45] Among U.S. issuers holding virtual meetings, Broadridge reports that the percentage of companies holding virtual-only meetings (rather than hybrid-virtual meetings) has also been increasing rapidly. In 2017, 90% of the virtual meetings held in the United States were virtual-only. Mid-way through 2018, Broadridge announced that virtual shareholder meeting adoption was up sharply through the first six months of 2018, with the company having facilitated its 1,000th virtual AGM. Broadridge also reported that during the first six months of 2018, U.S. public companies hosted 212 virtual meetings, up from 180 in the corresponding period in 2017. Broadridge estimates that the use of this technology in 2018 will increase to 300 for the full year, approximately a 30% increase over usage in 2017. Public company use of this technology to host virtual annual shareholder meetings has grown consistently since 2009 when Broadridge first introduced the technology.[46]

We note that under Delaware law (which governs over half of all U.S. publicly traded companies), the legal threshold that issuers must meet to hold virtual meetings is arguably even less onerous than under Canadian law. The Canadian federal requirement that the communication facility of a virtual meeting "permits all participants to communicate adequately with each other during the meeting" contrasts with the Delaware requirement that the communication facility of a virtual meeting provides participants with a "reasonable opportunity to participate in the meeting" and "to read or hear the proceedings of the meeting substantially concurrently with such proceedings."[47]

Proxy Advisory Firms and Governance Organizations Not Yet Weighing In

In Canada, proxy advisory firms and corporate governance watchdogs, such as the Canadian Coalition for Good Governance (CCGG), have not yet developed formal policies regarding virtual meetings. Below is a brief overview of some of the key players' positions or considerations pertaining to virtual meetings:

In Canada, proxy advisory firms and corporate governance watchdogs, such as the Canadian Coalition for Good Governance, have not yet developed formal policies regarding virtual meetings.

- **ISS.** The 2018 Annual Policy Survey of Institutional Shareholder Services, Inc. solicited feedback from ISS's clients on the use of virtual meetings. Survey respondents were asked to provide their views on the use of online mechanisms to facilitate shareholder participation at AGMs – that is, hybrid-virtual or virtual-only shareholder meetings. ISS reported that about one of every five investors (19%) responded that they would generally accept the practice of either hybrid-virtual or virtual-only shareholder meetings, without reservation. Eight percent of the respondent investors did not support either hybrid or virtual-only meetings. More than one-third (36%) indicated that they would generally accept the practice of hybrid AGMs, but not of virtual-only shareholder meetings, and approximately 32% of investor respondents indicated that they would accept the practice of hybrid-virtual shareholder meetings and that they would also be comfortable with virtual-only shareholder meetings if they provided the same shareholder rights as a physical meeting.[48]

- **Glass Lewis.** Glass Lewis & Co.'s position on virtual meetings is that "virtual meeting technology can be a useful complement to a traditional, in-person shareholder meeting by expanding participation of shareholders who are unable to attend a shareholder meeting in person (i.e., a 'hybrid meeting')," but that "virtual-only meetings have the potential to curb the ability of shareholders to meaningfully communicate with the company's management."[49] In its 2018 Canadian Policy Guidelines, Glass Lewis stated that in 2018 it will not make voting recommendations solely on the basis that a company is holding a virtual-only meeting, but that beginning in 2019 Glass Lewis will generally recommend voting "against" members of the issuer's governance committee if the board is planning to hold a virtual-only meeting and the issuer does not provide sufficiently robust disclosures in its proxy statement to assure shareholders that they will be afforded the same rights and opportunities to participate as they would at an in-person meeting.

- **SHARE.** The Shareholder Association for Research & Education has not published a formal policy regarding virtual meetings. However, in a 2014 comment letter that SHARE wrote to Industry Canada in the context of then proposed amendments to the CBCA, it stated that it was a proponent of hybrid-virtual meetings, but expressed its opposition to virtual-only meetings:

  > "Because the majority of shareholders do not attend shareholder meetings, a webcast provides a larger percentage of shareholders and other interested parties with the opportunity to observe these events. This is a very positive development. However, holding only virtual shareholder meetings could distance company representatives from shareholders, and thereby lessen accountability of the board and the company to them. The CBCA should continue to allow for participation in shareholder meetings by electronic means, but not permit the boards of publicly-listed companies to limit participation to an electronic-only or virtual format."[50]

- **CCGG.** To date, CCGG has not issued any formal guidance or policies on virtual meetings.

ISS's and Glass Lewis's positions are the same in the United States and Canada. The U.S. Council of Institutional Investors (CII), however, has been vocal regarding its opposition to virtual-only meetings. CII is a non-profit association of pension funds, employee benefit funds, endowments and foundations representing members with more than US$25 trillion under management and a leading voice on corporate governance and investor rights in the United States. In an email to Broadridge, published on CII's website, CII takes the position that shareholders deserve the choice to attend AGMs in person.[51]

It is interesting to note that in 2018, ISS adopted a position against virtual-only meetings in its U.K./Ireland and European Benchmark Voting Guidelines. For European companies, ISS will now generally recommend voting "for" proposals that allow for the convening of hybrid-virtual meetings, but will generally recommend "against" proposals that permit the convening of virtual-only meetings. We expect that ISS will develop consistent policies in Canada and the United States as the use of virtual meeting technology by public companies continues to rise in these jurisdictions.

Advantages of Virtual Meetings

The primary advantage of virtual meetings compared to traditional physical meetings is that they can increase access to shareholder meetings for a greater number of shareholders. For example, investors may consider travel costs for a physical shareholder meeting to be prohibitive, opting to attend a virtual meeting where they would not have otherwise attended a physical one. Virtual meetings also allow investors to more easily attend multiple meetings in a single day or short time frame during the often compressed proxy season, especially for shareholders invested in several issuers. These types of meetings may also improve accessibility for shareholders who are physically disabled. As a result, virtual meetings can increase engagement and participation, and are considered by some to be more efficient and convenient for participants.

One benefit that is specific to hybrid-virtual meetings is that, by allowing shareholders to attend either in-person or online, they afford the greatest optionality for a shareholder's participation in shareholder meetings. Hybrid-virtual meetings can also generate positive media coverage for an issuer that positions itself as taking advantage of emerging innovative technologies.

A benefit that is specific to virtual-only meetings is that they are less expensive for both attendees and issuers than traditional physical meetings. Virtual meetings may also allow for easier management of inappropriate or disruptive shareholders than in a physical setting.

Disadvantages of Virtual Meetings

A principal disadvantage of virtual meetings compared to traditional physical meetings is the potential for technical issues to disrupt or delay the meeting. This is especially the case as technology continues to evolve and the practice remains infrequent and therefore less tested.

Another downside of hybrid-virtual meetings is that they are typically more expensive for issuers than traditional physical meetings, forcing issuers to incur all of the costs of a physical meeting, as well as the often not-insignificant costs associated with engaging a service provider to implement and oversee the virtual component.

There are also additional disadvantages that are specific to virtual-only meetings, the most notable being that virtual-only meetings can impede shareholder engagement and communication. There remains concern that issuers may silence opposition by selecting only favourable shareholder questions. Adopting a virtual-only format can also result in the absence of any "face time" between issuers' directors and officers, on the one hand, and their shareholders, on the other – thereby lessening shareholders access to the companies they invest in, and lessening those companies' accountability and transparency to their investors. Furthermore, connecting to an online virtual-only meeting web portal requires a level of technological sophistication that can create impediments for, and potentially disenfranchise, shareholders who are less "tech savvy."

In practice, another downside of the virtual-only format is the potential for unfavourable media coverage as a result of concerned and vocal investors. For example, in a saga covered by the *Financial Times* in 2017 and 2018, the Sisters of St. Francis, a 400-strong order of nuns in Philadelphia, successfully led a campaign to convince ConocoPhillips to reintroduce physical meetings after the issuer had adopted a virtual-only format.

Going Virtual? Top 10 Issues to Consider

If you are considering whether to adopt a virtual meeting format, below are the top issues the board and senior management should evaluate.

1 **Timing.** An issuer's first virtual meeting should address only uncontentious matters, so as not to give the appearance that the underlying motive for switching to a virtual format is intended to, or may in effect, supress shareholder dissent. Given the current trends in virtual meetings, at this stage, we would not recommend that Canadian public issuers move to virtual-only meetings without broad-based investor support for the practice. And, even then, do so only after careful consideration and preparation to avoid any unintended negative consequences.

2 **Shareholder consultation.** Issuers should consider how their shareholder base would be affected or would react to a virtual meeting format and whether holding a virtual meeting would result in significant "withhold" or "against" votes in the election of its directors or other business being put before shareholders at the meeting. Before issuers decide whether to hold a virtual meeting, we recommend that they engage with their top shareholders to canvass their views on virtual meetings. Issuers might also consider holding a non-binding advisory shareholder vote on whether or not to move to a virtual format, before taking any formal steps to do so.

> Before issuers decide whether to hold a virtual meeting, we recommend that they engage with their top shareholders to canvass their views. Issuers might also consider holding a non-binding advisory shareholder vote on whether or not to move to a virtual format, before taking any formal steps to do so.

3 **Audio or audio-video.** Issuers should consider whether to include a live video-streaming component in the virtual meeting. While audio-only virtual meetings can typically satisfy Canadian legal requirements for holding a virtual meeting, some issuers choose to stream the meeting by way of webcast. Certain governance organizations and shareholders prefer the addition of a visual element and the increased transparency associated with it. However, setting up the technology to accommodate a visual component entails increased costs for the issuer; some issuers are also concerned about the possibility of embarrassing contentious moments being captured on camera. In practice, a significant majority of U.S. companies that hold virtual meetings opt for audio-only virtual meetings.

4 **Adequacy of communication.** Canadian issuers adopting a virtual meeting format must implement procedures to enable participants to "communicate adequately with each other" in compliance with Canadian law. Third-party service providers should equally ensure that their technology platform remains compliant with Canadian requirements.

5 **Shareholder authentication and voting.** Issuers must be able to verify that each participant accessing a virtual meeting remotely is a legitimate shareholder or proxyholder. This task is usually delegated to a third-party service provider, and verification is most frequently accomplished through the inclusion of a unique code in each shareholder's proxy materials that can be used to access the virtual meeting's online portal. Capable scrutineers and vote tabulators are key to ensuring a fair, reliable and verifiable voting process; this is particularly important given the existing complexities with the proxy voting system – complexities that can be magnified where voting via webcast or telephone is being permitted in addition to voting in person and by proxy.

6 **Protecting against technological complications.** Issuers should consider whether it would be necessary or prudent to engage a technical support line, through which shareholders may obtain assistance and instructions when using virtual meeting software. Issuers should also have contingency procedures in place in the event of technological problems (such as a power or network outage). We recommend that issuers structure their meeting agendas to conclude all voting and formal business as quickly as possible.

7 **Access.** Issuers must decide whether to permit non-shareholders (such as analysts, employees, or media representatives) to attend a virtual meeting. A large majority of U.S. public companies allow non-shareholders to attend but have implemented systems and controls to ensure they are prevented from voting or asking questions. Issuers must also determine whether to publish the audio or webcast recording of the virtual meeting on the issuer's website following the meeting.

8 **Shareholder proposals.** Consideration must be given to the way shareholders would be permitted to present shareholder proposals, whether live through a dial-in number or by pre-recording an audio or video statement. Currently, the most common method is an operator-assisted phone line that shareholders can call during the meeting. Whatever method is chosen, every effort should be made to ensure equal shareholder rights and access during the meeting.

9 **Shareholder questions.** How will shareholders be permitted to ask questions during a virtual meeting? For example, must questions be submitted in advance? Will questions be allowed via text messaging in real time or can they be asked live through a dial-in number managed by an operator? Issuers must also decide (i) how shareholder questions will be selected for answering, to ensure transparency; (ii) whether to share all submitted questions with the shareholders participating at the meeting; and (iii) whether to respond after the virtual meeting to all questions that were not answered during the meeting because of timing restraints. Some governance organizations have recommended that to build investor confidence in the process, issuers appoint an independent moderator to manage questions.

10 **Proxy materials.** Consider what information is material and should be included in the issuer's public disclosure documents regarding switching to a virtual meeting format (especially a switch to a virtual-only format). Issuers should consult the policies and guidelines of influential corporate governance actors and institutional investors regarding recommended best practices.

The issuer should factor the above considerations into a cost-benefit analysis performed with the assistance of legal counsel and an appropriate third-party service provider to determine the most appropriate, reliable and cost-effective modality for its shareholder meeting.

Our Take: Carefully Balance Benefits Against Risks

Use of remote meeting technology is a nascent trend that is gaining increased attention in Canada. Investors, issuers and proxy advisory firms are closely examining the merits of adopting virtual meetings and debating whether and how they should be conducted. With many influential governance organizations and institutional investors currently reserving their opinions on the topic, the 2019 proxy seasons may be decisive regarding the future of virtual shareholder meetings in Canada. In the meantime, Canadian boards and senior management of public companies should carefully consider whether the benefits of virtual meetings will serve to enfranchise shareholders and improve access and engagement; if not, it may be premature to adopt a virtual meeting format, at least until all of the issues and associated benefits and costs are properly evaluated. Given many of the risks and criticisms of virtual-only meetings, hybrid-virtual meetings may be the more prudent course for those issuers looking to take advantage of innovative technologies and efficiencies in order to increase shareholder participation at annual meetings.

CHAPTER 04

Climate Change and Sustainability: Responsible Investing and Climate-Related Disclosure Gaining Traction

In our *Davies Governance Insights 2017*,[52] we discussed for the first time the increased focus by regulators and the investment community on environmental and sustainability factors as part of the risk identification, disclosure and mitigation strategies of public issuers. Climate change issues and sustainable investing, which are part of the broader environmental, social and governance (ESG) movement, continue to gain traction. In 2017 and into 2018, we saw additional efforts to incorporate climate change and sustainability factors into investors' investment strategies and into issuers' financial reporting and disclosure practices. Here, we discuss notable developments in climate change–related disclosure and sustainability reporting, responsible investing steps taken by institutional investors, and climate change–related shareholder proposals that have garnered significant stakeholder support.

Recent Developments in Climate Change–Related Disclosure and Sustainability Reporting

CSA REPORT ON CLIMATE CHANGE-RELATED DISCLOSURE PROJECT

In April 2018, the Canadian Securities Administrators (CSA) released its "Report on Climate change-related Disclosure Project" (the CSA Report)[53] as part of a previously announced undertaking to review the disclosure of risks to, and financial impacts on, issuers associated with climate change and the governance processes related to them.

The CSA canvassed 78 Composite Index issuers on their current practices in relation to mandatory and voluntary disclosure of climate change–related information (Issuer Survey). The CSA also conducted a targeted review of select large Canadian issuers in a number of industries (Disclosure Review). The project included focused consultations with issuers, users and other stakeholders (Consultations). The Issuer Survey revealed that more than half of the canvassed issuers provided specific climate change–related disclosure in their management's discussion and analysis (MD&A) and/or annual information forms (AIF) – focusing mostly on regulatory risk – with the remaining issuers providing either boilerplate disclosure or no disclosure at all. Generally, climate change–related disclosure was more common among issuers in the oil and gas industry. When climate change–related risk was not provided in continuous disclosure documents, the principal reason given by issuers was that such disclosure was not material from a Canadian securities law perspective. Uncertainty surrounding the timing and measurement of climate change–related risks presented a particular challenge for issuers with respect to assessing their materiality.

More Canadian issuers provided climate change–related disclosure in their voluntary reports (85% of the respondents to the Disclosure Review and 32% of the respondents to the Issuer Survey). Of the various voluntary disclosure frameworks used, most issuers applied the Global Reporting Initiative (GRI) Framework. Briefly, the GRI Standards are global standards for sustainability reporting, featuring a modular, interrelated structure, and offering a global best practice for reporting on a range of economic, environmental and social impacts. Sustainability reporting based on the GRI Standards seeks to assist companies in providing information about their positive or negative contributions to sustainable development, presented in a sustainability report focused on material topics.[54]

Substantially all investors and stakeholders participating in the Consultations expressed general dissatisfaction with the current state of climate change–related disclosure being provided by issuers, noting that in many cases disclosure is not provided or is boilerplate, vague, incomplete or inconsistent, thereby limiting investors' ability to compare disclosure among issuers. Investors also identified as a key challenge determining whether an issuer had conducted an appropriate materiality assessment with respect to climate risks. Many investors supported the recommendations of the Financial Stability Board Task Force on Climate-related Financial Disclosures (TCFD) on disclosure regarding governance and oversight of climate change–related risks. Despite this feedback, a substantial number of issuers noted little or no demand on the part of investors and other stakeholders for climate change–related information.

According to the CSA Report, there was no consensus among the issuers consulted as to whether there should be a single prescribed framework for climate change–related disclosure. Many issuers were of the view that a single framework would prove inadequate to accommodate the specific circumstances of the different industries and issuers, and that a "one-size-fits-all" approach would not meet the needs of issuers or investors. Concerns raised by issuers regarding a

mandatory disclosure framework included potential increases in the cost of compliance and additional regulatory burden that may be disproportionate to any potential benefits realized by investors.

The CSA intends to use its review to develop guidance and educational initiatives for issuers with respect to the business risks, opportunities and potential financial impacts of climate change; to continue to monitor the development of international best practices in the area of mandatory and voluntary disclosure; and to consider new disclosure requirements regarding climate change governance and risk management practices.

LAUNCH OF THE NEW YORK "BOARDROOM ACCOUNTABILITY PROJECT 2.0": CLIMATE EXPERTISE IN THE BOARDROOM

In September 2017, New York City Comptroller Scott M. Stringer and the New York City Pension Funds announced the launch of the National Boardroom Accountability Project Campaign Version 2.0, an initiative that calls on the boards of over 150 U.S. public companies to increase board members' diversity, independence and climate competence.[55] Although the primary focus of this project is on diversity, the Comptroller and the NYC Pension Funds are pressuring U.S. issuers to commit to working with them and other large, long-term shareholders to identify suitable independent candidates, including those who bring climate expertise to the boardroom. As part of the launch of the second phase of the project, the Comptroller sent letters to the nominating and governance committee chairs of 151 companies requesting a dialogue on their processes for adding, evaluating and replacing board members. In some cases, the companies contacted were targeted for having substantial exposure to risks related to climate change, such as reliance on carbon-intensive business practices.

The initial response rate to the engagement letters has been extremely high. The Comptroller's Office has indicated that it has had meaningful engagements with over half of the companies, with many more engagements planned in the near future.[56]

INVESTORS SPEAK OUT: RELEASE OF JOINT DECLARATION OF INSTITUTIONAL INVESTORS ON CLIMATE-RELATED FINANCIAL RISKS

On October 26, 2017, 30 Canadian and international financial institutions and pension funds, representing approximately C$1.2 trillion in assets under management, issued a joint *Declaration of Institutional Investors on Climate-Related Financial Risks* (Declaration) calling on public issuers in Canada to commit to enhanced disclosure on their exposure to climate change risks and the measures being taken to manage them.[57] The signatories to the Declaration include Finance Montréal, Desjardins, Caisse de dépôt et placement du Québec and the British Columbia Investment Management Corporation. The Declaration is also supported in principle by 13 organizations, including the Finance and Sustainability Initiative and the Investment Industry Association of Canada.

The Declaration is an effort to respond to the perceived inadequacy of disclosure of climate change-related information in Canada. The Declaration states that information regarding exposure to climate–change risks is essential for investors to make sound financial decisions. The Declaration signatories have committed, among other things, to encourage Canadian public companies to adopt a financial disclosure framework regarding their exposure to climate change risks; to identify and assess investment opportunities that are low in emissions or that promote the energy transition; and to collaborate with their investee companies to support them in managing their climate risks.

Spotlight: Growing Support for the Task Force on Climate-Related Financial Disclosures

As discussed in our *Davies Governance Insights 2017*,[58] in December 2015 the international Financial Stability Board (FSB) established the Task Force on Climate-related Financial Disclosures (TCFD) with a view to increasing the effectiveness of disclosures about climate change. The TCFD recommended voluntary, consistent climate-related financial disclosure for companies to use when providing information to lenders, insurers, investors and other stakeholders.[59]

The TCFD issued its final report and recommendations to the FSB in June 2017. These recommendations are structured around four thematic areas: governance, strategy, risk management, and metrics and targets. More than 100 firms, with combined market capitalizations of over US$3.3 trillion and financial firms responsible for assets of more than US$24 trillion, joined in a statement of support for the TCFD report and recommendations, urging broader adoption by companies.[60]

In December 2017, the TCFD issued a press release announcing that since the release of its recommendations in June 2017, the number of companies and organizations supporting the organization had more than doubled, reaching 237 companies with a combined market capitalization of over $6.3 trillion.[61] Major Canadian companies on the list include the Canada Pension Plan Investment Board, Caisse de dépôt et placement du Québec, OMERS, AIMCo, BCIMCo, Manulife Financial Corp., Royal Bank of Canada, TD Bank, CIBC, Scotiabank, Barrick Gold Corporation and Suncor Energy Inc.[62]

In November 2017, the Centre for International Governance Innovation published a policy brief emphasizing that disclosure of financial information related to climate change remains fragmented and inadequate in Canada.[63] The policy brief argues for robust implementation of the TCFD's recommendations by Canadian organizations and issuers.

Earlier this year, the TCFD, together with the Climate Disclosure Standards Board, launched a new knowledge hub, intended to provide (free) guidance for businesses implementing the TCFD's recommendations.[64]

CLIMATE CHANGE REPORTING ON THE RISE

In December 2017, the Centre for Sustainability and Excellence (CSE) published its annual research on sustainability reporting trends. The report, titled *Sustainability Reporting Trends in North America 2017*,[65] found that two-thirds of companies with the highest rankings on sustainability ratings had better financial performance than companies with lower rankings during the period 2014–2016.[66] These companies tended to have clearly stated goals and targets relating to sustainability, external assurances of performance and better reporting practices – suggesting that sustainability reporting may have a positive impact on revenues. Carbon footprint reduction has also become a priority for the companies that have the highest sustainability rankings. The report also found that the use of specific guidelines for reporting is growing and, although many guidelines are available, 65% of companies use the GRI Sustainability Reporting Guidelines, which are the first adopted global standards for sustainability reporting.

According to CSE's founder and president, the greatest room for improvement is in the adoption of the United Nations' Sustainability Development Goals (SDGs) and of more comprehensive strategic goals related to social, environmental and transparency topics.[67] However, although incorporating the SDGs has proceeded slowly in North America, 41% of businesses are expected to embed the goals into their strategy and business practices within five years, and 71% of businesses say they are already planning how they will incorporate the SDGs.[68]

FIGURE 4-1: UNITED NATIONS' SUSTAINABLE DEVELOPMENT GOALS (SDGs)

Responsible Investing by Institutional Investors and Engaged Shareholders

In 2017, we witnessed a surge in the promotion of responsible investment topics, with institutional investors and engaged shareholders being increasingly concerned with ESG factors and their impact on returns. For example, a recent report by US SIF: The Forum for Sustainable and Responsible Investment reveals that climate change is a factor increasingly considered by U.S. money managers and institutional investors in their decision-making.[69] According to the report, climate change as a factor entered into US$1.4 trillion of investments by the professionals in 2016, more than a 500% gain over two years. As ESG investing becomes more mainstream, according to the report, investment firms are practising sustainable and responsible investing strategies to pursue positive social and environmental impacts, minimize risk, improve financial returns and fulfill fiduciary duties. In addition, during the period covered by the report, 176 institutional investors and 49 investment managers controlling a total of US$2.56 trillion in assets filed and co-filed shareholder resolutions on ESG matters.

The increasing integration of social responsibility considerations into investment frameworks demands that public companies stay ahead of these issues and engage with investors. Other notable examples of this trend include the following:

– **The Caisse's Investment Strategy.** In October 2017, Caisse de dépôt et placement du Québec announced its eight-year investment strategy to address climate change.[70] As part of this strategy, it will consider climate change as a factor in all investment decisions across its entire portfolio. Representatives of the Caisse have noted that an increasing number of shareholder resolutions for publicly listed companies are on climate change issues. The Caisse has set a short-term target to increase its investments in low-carbon assets by 50% by 2020, representing more than $8 billion in new investment. It has also set a medium-term target to reduce its carbon footprint by 25% per dollar invested by 2025, making it the first institutional investor in North America to set a carbon target covering all of its asset classes. The Caisse will also, as part of this strategy, reduce its exposure to assets with the highest carbon intensity in its portfolio. It is expected to report annually on the progress of these targets.

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- **CPPIB's Sustainable Investing Report.** The Canada Pension Plan Investment Board *2017 Sustainable Investing Report* emphasizes that CPPIB will consider ESG matters when making investment decisions and engaging with companies.[71] In 2017, CPPIB supported more than 30 climate change–related shareholder resolutions seeking deeper disclosure on climate change–related risks and opportunities, including at ExxonMobil Corporation and Occidental Petroleum Corp. (discussed in further detail below). CPPIB also supports the recommendations of TCFD discussed above.

- **The BlackRock Perspective.** Earlier this year, the chair and CEO of BlackRock, Inc. sent his annual letter to CEOs of public companies outlining BlackRock's expectations for companies to fulfill their corporate social responsibilities.[72] The letter calls for companies to make positive contributions to society and to benefit all stakeholders in addition to delivering financial performance; the letter identifies having a clear social purpose as critical to a company's long-term growth and value. The letter also calls for companies to more clearly articulate their long-term strategies, including by identifying structural trends, such as climate change, that affect the potential for growth. Subsequently, in March 2018, BlackRock released its *Investment Stewardship Engagement Priorities for 2018* (Engagement Priorities), providing guidance on how BlackRock will engage with companies on their governance.[73] The Engagement Priorities cite the emerging concept of a "climate competent board." For directors of companies in sectors that are significantly exposed to climate risk, BlackRock expects the whole board to have demonstrable fluency in the way climate risk affects the approach of the business and management to adapting the long-term strategy and mitigating the risk. BlackRock will assess this level of fluency through corporate disclosures and direct engagement with independent board members, if necessary. Where it has concerns that the board is not dealing with a material risk appropriately, BlackRock may vote against the election of certain directors it deems most responsible for board process and risk oversight; and it may, potentially, vote in favour of shareholder proposals that raise such issues.[74] The BlackRock Engagement Priorities also emphasize BlackRock's continued support for the TCFD recommendations. Over the course of 2018 and 2019, BlackRock will continue to engage with companies most exposed to climate risk to understand their views on the TCFD recommendations and to encourage them to consider using TCFD's reporting framework as it evolves over time.

In Focus: U.S. Shareholder Proposals on Climate Change Attract Growing Shareholder Support

In 2017, a record number of environment and social-oriented shareholder proposals were advanced in the United States, with a subset receiving unprecedented shareholder voting support.[75] The three shareholder proposals discussed below were the first resolutions to garner majority votes for annual disclosure on the impact of long-term climate change on the business.[76] According to governance specialists, the success of these climate change risk shareholder proposals marked a turning point for climate-related proposals.

- **Occidental Petroleum Corp.** A majority of Occidental Petroleum Corp. shareholders voted in favour of a climate change disclosure proposal requesting that Occidental provide an assessment of the company's portfolio under a "two-degree" scenario – the concept of limiting the average global temperature increase to two degrees Celsius in accordance with the Paris Climate Accord.[77] The proposal to Occidental was submitted by Wespath Investment Management and the Nathan Cummings Foundation and was subsequently also supported by a coalition of other large asset owners that included the California Public Employees' Retirement System (CalPERS).[78] The success marked the first time this type of proposal has passed over a board's objection.[79] In response to the proposal, in March 2018 Occidental issued a report on the risks that climate change poses to its business.[80]

- **PPL Corporation.** A majority of shareholders of PPL Corporation voted in favour of a shareholder proposal submitted by the New York State Common Retirement Fund, calling on PPL to conduct a two-degree scenario analysis on its full portfolio of power generation assets and planned capital expenditures through 2040.[81] In response, PPL released a report outlining its plans to cut carbon emissions by 2050.[82] PPL, which generates electricity in Kentucky only, expects a decline in carbon dioxide emissions at its power plants of between 45% and 90% by 2050.[83]

- **ExxonMobil Corporation.** Over 60% of ExxonMobil Corporation shareholders approved a climate disclosure proposal submitted by the New York State Common Retirement Fund requesting that ExxonMobile disclose the impact of a two-degree scenario on the company's asset portfolio, including the financial risks associated with such a scenario.[84] The proposal was supported by major institutional shareholders, including BlackRock and Vanguard, marking a shift from the past positions of these holders on climate-related proposals. Both Institutional Shareholder Services, Inc. (ISS) and Glass Lewis & Co. (Glass Lewis) recommended voting in favour of the proposal.[85] The success of the proposal was hailed by the trustee of the New York State Common Retirement Fund as "an unprecedented victory for investors in the fight to ensure a smooth transition to a low carbon economy."[86] In response, ExxonMobile agreed to publish climate impact reports and, in early 2018, released a climate risk report and its annual Energy Outlook for 2018.[87] New disclosures to investors include "energy demand sensitivities, the implications of two degree Celsius scenarios, and its positioning for a lower-carbon future."[88]

Certain companies have responded to the increased investor scrutiny by improving their climate-related disclosure. In March 2017, Chevron Corporation's release of its climate risk management report in response to a shareholder proposal resulted in the proposal being withdrawn, demonstrating that improved transparency as a result of engagement may go far in addressing investor concerns.[89] In March 2018, Chevron issued a second climate report for investors, describing its approach to managing climate change risks and its resilience under a low carbon scenario, including more detail on Chevron's approach to governance, risk management and emission-reduction investments and activities, as well as key metrics.[90]

In Canada, where environment and social-oriented shareholder proposals have been less common, three climate-related proposals were advanced in 2017 at Enbridge Inc. and Industrial Alliance Insurance and Financial Services Inc. shareholders' meetings, but were not approved by a majority of shareholders. The rise in ESG shareholder proposals in the United States and shareholders' success in getting climate-related proposals approved at U.S. energy companies suggest that Canadian issuers can expect similar trends in the future.

Shareholders have not been the only stakeholders exerting pressure on companies in the area of climate change. In January 2018, the New York City Government launched a lawsuit against major oil companies BP Plc, Chevron Corporation, ConocoPhillips, ExxonMobil Corporation and Royal Dutch Shell Plc, claiming that they have disproportionately contributed to climate change and downplayed its risks. This new scrutiny has placed greater pressure on companies, especially those in the energy sector, to respond to demands for increased transparency in climate change reporting.

Proxy Advisory Firms Developing Climate-Related Recommendations

In December 2017, Glass Lewis and ISS released their updated proxy voting guidelines for 2018 for Canada and the United States. Both proxy firms' guidelines for the United States include new guidance on shareholder proposals relating to climate change. In addition, the 2018 launch of ISS's "Environmental and Social QualityScore," which measures the quality of corporate disclosures on environmental and social issues by 4,700 listed companies across 24 industry groups in the Americas and European and Australasia regions, suggests that ESG factors are also becoming an increasingly important focus for the proxy advisory firms.

In 2018, ISS also updated its policy on climate change risk shareholder proposals to align it with the recommendations of the TCFD.[91] ISS now generally recommends voting "for" shareholder proposals that request to disclose information on the financial, physical or regulatory risks related to climate change on its operations and investments or on how the company identifies, measures and manages such risks. Factors considered in making the recommendation include the following:

- whether the company already provides current, publicly available information on the impact that climate change may have on it, as well as any associated company policies and procedures to address related risks and/ or opportunities;
- the company's level of disclosure compared to that of industry peers; and
- whether there are significant controversies, fines, penalties or litigation associated with the company's climate change–related performance.

Glass Lewis also expanded its policy on climate change–related shareholder proposals for the 2018 proxy season.[92] Below are some of the highlights of the 2018 Glass Lewis guidelines for the United States.

- Glass Lewis will generally support shareholder resolutions that request issuers in certain extractive or energy-intensive industries to provide information to shareholders concerning their climate change scenario analyses and other climate change–related considerations.
- Although Glass Lewis is generally supportive of the disclosure recommendations recently developed by the TCFD, it will review on a case-by-case basis proposals requesting that issuers report in accordance with these recommendations.
- When reviewing proposals requesting increased disclosure on these issues, Glass Lewis will evaluate various factors, including industry, the issuer's current level of disclosure, oversight afforded to climate change–related issues and peer group oversight and disclosures.

In Canada, ISS generally assesses shareholder proposals relating to social or environmental issues on a case-by-case basis, taking into consideration whether the implementation of the proposal is likely to enhance or protect shareholder value while also considering various other enumerated factors.[93] And although the 2018 Glass Lewis guidelines for Canada do not discuss climate-related shareholder proposals, they do emphasize the importance of disclosing and managing environmental risks.[94] In cases in which the board or management has failed to sufficiently identify and manage a material environmental or social risk that did or could negatively affect shareholder value, Glass Lewis will recommend that shareholders vote against directors responsible for risk oversight in consideration of the nature of the risk and the potential effect on shareholder value.

Our Take: Build ESG Competencies and Incorporate Climate Change into Disclosure and Reporting Practices

In light of the continued trends toward responsible investing, sustainable business practices and strategies, and calls for increased transparency concerning climate-related risks and risk management, boards should ensure they understand how climate-related risks apply to their business and plans, particularly in industries where those risks are magnified. To that end, boards should ensure their members possess the requisite skills and expertise needed to understand and address ESG-related risks. It is also a good practice to consider ESG capabilities as they relate to the company's industry, financial responsibilities and risk profile when recruiting new directors. Boards should also ensure that management conducts a risk analysis of company operations that includes environmental and social matters, and that it reports to shareholders on material climate and sustainability-related risks.

Boards and management should also spend time investigating and understanding available climate-related disclosure standards and frameworks, drawing from available guidance that can help issuers build sustainability into their longer-term plans and create opportunities to enhance long-term returns for investors.

Lastly, as with many other ESG topics under focus, issuers should engage with their stakeholders to understand their investment rationales and perspectives on climate change and sustainability, as well as their expectations concerning disclosure in this area.

We anticipate that many issuers, particularly larger companies in industries most affected by climate change and sustainable development issues, will face increased pressure to build these factors into their plans and programs. We also expect to see greater disclosure requirements and guidance in this area from Canadian regulators.

CHAPTER 05

Updates in Shareholder Activism: 2018 Trends and Developments

The year 2018 has been a robust one for shareholder activism. This is true for both formal proxy contests and behind-the-scenes private engagement between issuers and traditional activists as well as passive investors. In this chapter, we discuss some of this year's proxy contest activity and trends, including the heated campaign to replace a minority of the board of Crescent Point Energy Corp. We zoom in on the key industries likely to be the subject of heightened levels of activism in the future, including the mining sector and the growing cannabis industry in Canada. We consider ISS's updated 2018 proxy contest guidelines and their implications for campaigns seeking a majority as opposed to minority changes to the board. We also provide an update on the continuing scrutiny of soliciting dealer fees (or "vote buying") in proxy contests, examine developments in environmental, social and governance issues relevant to shareholder activism, and spotlight "withhold" campaigns as a tool for "activism lite."

Proxy Contest Activity in 2018: Key Highlights and Predictions

Canadian formal proxy contest activity through the first eight months of 2018 is trending higher than in prior years (29 compared with 19 over the same time period in 2017). If the current pace of activity continues, 2018 may go down as one of the busiest years since 2009 in terms of the number of companies targeted. The breakdown of proxy contests in 2018 is roughly consistent with that in 2017:

- In 15 (approximately 50%) of the formal contests to date, activists sought to replace either a majority of the board of directors or the entire board.
- An additional four (approximately 15%) were "short-slate" campaigns targeting a minority of the board.
- The remaining 10 (approximately 35%) related to transactional or other non-board matters.

And while measuring success is never a precise science, overall success rates are roughly evenly split so far this year: issuers being successful in 50% of completed contests, and activists achieving some or all of their objectives in the balance of the completed contests.[95]

The natural resource and energy sector is once again the leading focus of activist campaigns, with over half of all proxy contests announced in 2018 to date targeting issuers in the metals and mining, and oil and gas sectors. The financial, real estate, technology, consumer and industrial sectors have also experienced activity this year.

We expect the mining industry will continue to face activism in the coming years, with criticisms being levelled against key players in this industry by Paulson & Co., beginning at the Denver Gold Show in September 2017. Paulson has criticized the gold industry for its poor total shareholder returns, citing a pattern of value-destructive acquisitions since 2010, a history of excessive executive compensation, and cronyism on company boards.[96] Paulson's call to action at the Denver Gold Show – that gold investors form a coalition to engage with companies on operational and governance matters – was successful. On September 21, 2018, Paulson announced that 15 other investors had joined to form the "Shareholders' Gold Council" to ensure that management and boards of mining companies are aligned with shareholder interests.[97] According to statements by the head of the Council, launching it took longer than expected because of compliance issues and housekeeping challenges dealing with 16 institutions and back-office teams.[98] The Council intends to ensure that the management and boards of mining companies are aligned with shareholder interests. The group will meet periodically to address a number of issues and will be funded by its members. In the meantime, Paulson has launched an activist campaign against Detour Gold Corporation, urging the company to explore a possible sale and requisitioning a shareholders' meeting at which Paulson proposes to replace the company's board.

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Spotlight: Activism in the Cannabis Space: the Next Weed War?

Capital markets activity in the Canadian cannabis sector has achieved unprecedented highs, including significant equity and debt raises, continued consolidation in the industry as producers race to gain a competitive advantage, the opening of U.S. equity markets to Canadian cannabis issuers and an increasing number of companies with U.S. cannabis operations being listed on the Canadian Securities Exchange (CSE). **Although the cannabis industry has not yet faced significant activism, at least publicly, that may be changing.**

Take the recent sale of MedReleaf Corp. to Aurora Cannabis Inc. in July 2018. Shareholders representing approximately 49% of the outstanding shares of MedReleaf acted on their concern with the performance of the company's business and common share trading price and catalyzed its sale to Aurora, bringing together two of Canada's largest cannabis companies in a transaction valued at approximately $3.2 billion.[99] In early September 2018, New York–based investment firm Riposte Capital, LLC, sent an open letter to the board and CEO of TSX-listed HEXO Corp. (formerly Hydropothecary Corp.) expressing concern about the "severely depressed valuation of HEXO in spite of significant positive milestones and developments," including HEXO's contract with Québec's SAQ and its joint venture with Molson Coors.[100] Riposte asked HEXO to initiate a strategic review to identify alternatives to maximize shareholder value; these included engaging with potentially interested buyers of HEXO; considering taking the company private; securing capital investments in HEXO from Molson Coors; and/or pursuing an accretive merger to enhance diversification, expertise, scale and international expansion. At the time of writing this report, HEXO responded that there was no formal strategic review process at this time;[101] it remains to be seen if Riposte's actions will escalate or lead to a transaction or other changes at HEXO.

As the cannabis frenzy continues with the impending opening of the recreational cannabis market in mid-October 2018, some issuers in the space may start to face greater scrutiny and engagement about their governance and compensation practices, as well as their leadership structures. Increasingly, cannabis issuers are seeing their shareholder bases change significantly, with the entrance of many institutional and other sophisticated investors within and outside Canada. Management and boards operating in this industry should start reviewing their organizations' policies and practices to ensure they are in line with best practices and evolving investor expectations. Key areas likely to attract focus include misalignments between pay and performance, a lack of diversity and/or skills among the issuers' leadership, lack of independence at the board level and criticisms of long-term strategy and execution.

The Contest at Crescent Point Energy

One high-profile proxy contest in 2018 was Cation Capital Inc.'s campaign to replace 4 of the 10 directors on the board of TSX- and NYSE-listed issuer Crescent Point Energy Corp., which started with Cation publicly expressing concerns with the then-current state of governance, strategy and operations of Crescent Point.[102]

Crescent Point was an obvious target for shareholder activism: according to Cation, it was the worst performing issuer in its peer group, having underperformed for five years, with a declining stock price and declining dividends to match.[103] In the same period, Crescent Point's debt level materially increased while two dilutive equity raises were completed at declining prices. As discussed in chapter 7, Executive and Director Compensation Trends and Issues: A Three-Year Review, executive compensation was also a weak spot for Crescent Point, with management securing a narrow win of 56% support on its advisory say-on-pay shareholder vote in 2014, and losing decisively in 2016 with 70% of shareholders voting "against" the company's approach to executive compensation. Against this backdrop, Crescent Point was labelled by some as a value-destruction machine and several analysts openly called for management and board change.[104]

Enter Cation Capital, a newly formed private investment firm. With just 0.3% of the outstanding shares, representing an investment of approximately $13 million, Cation launched a proxy contest on April 10, 2018, seeking to replace 40% of the board.[105] Proxy contests in which an activist has a meaningful investment but small absolute ownership position are not without precedent at large and megacap issuers in the United States; however, even in the smaller Canadian context, the low value of Cation's investment in Crescent Point represented a challenge. Some perceived that Cation's credibility was also hampered by its campaign; although it took full advantage of Crescent Point's weaknesses – focusing its messaging on the underperforming stock, decreasing dividends and misaligned executive pay – Cation was criticized for not articulating a clear turnaround strategy to create shareholder value.[106]

Institutional Shareholder Services, Inc. (ISS) and Glass Lewis & Co. (Glass Lewis) published divergent voting recommendations to their clients. Glass Lewis sided with Crescent Point's incumbent board, criticizing Cation's proposals as weak. In doing so, however, Glass Lewis left its own recommendation open to criticism by apparently meeting with Crescent Point's representatives but refusing to meet with representatives of Cation. ISS, on the other hand, split its recommendation, siding with Cation in part by finding that it had made a reasonably compelling case for change, but supporting only two of Cation's four director nominees. ISS's recommendation is consistent with what some consider to be the lower hurdle it imposes on short-slate (or minority board) nominations (see ISS 2018 Proxy Contest Guidelines: Treatment of Special Situations, below, for further details).

Although Cation lost the vote at the Crescent Point shareholders' meeting held on May 4, 2018, two of its nominees made a strong showing, receiving 41% and 44% votes "for," respectively.[107] Crescent Point also failed to achieve majority shareholder support for its say-on-pay vote, with 61% of shareholders voting "against" its approach to executive compensation: a clear message of shareholder discontent. Seemingly heeding this message less than a month after the vote, Crescent Point's CEO stepped down and a search was launched for his replacement. Such a management change is consistent with anecdotal observations that, in many instances, win or lose, the CEO pays the price following a proxy contest. In July 2018, Cation renewed its "acute concerns with the ongoing governance and operations of Crescent Point, the lack of transparency regarding

its process to find the most qualified CEO and the board's stall tactics to delay meeting with Cation until it has made irreversible decisions, thereby rendering shareholder input extraneous."[108] Subsequently, Crescent Point announced other changes to its governance and operations, including the appointment of a new CEO, cuts to its capital budget and changes in its executive compensation program.[109]

ISS 2018 Proxy Contest Guidelines: Treatment of Special Situations

ISS has the largest market share among proxy advisory firms and can influence a significant percentage of the votes in a proxy contest. Understanding ISS's proxy contest guidelines and navigating the ISS recommendation process is therefore an important element for issuers and activists in any proxy contest.

Under its 2018 guidelines, in reviewing contested director elections, ISS focuses on two central questions:[110]

- Has the activist met the burden of proving that board change is warranted?
- If so, will the activist's nominees be more likely than the incumbents to effect positive change?

In answering these questions, ISS considers a number of factors, including (i) the long-term financial performance of the issuer relative to its industry; (ii) management's track record; (iii) the background to the proxy contest; (iv) board nominee qualifications and compensation arrangements; (v) the activist's strategic plan and the quality of its critique of management; (vi) the likelihood that the proposed goals and objectives of each side can be achieved; and (vii) the activist's relative stock ownership position.

ISS draws a distinction between an activist that seeks to change a majority of the board and one that puts forward a minority or short slate. When an activist seeks to change a majority of the board, ISS requires that it put forward a well-reasoned and detailed business plan (including strategic initiatives), together with a transition plan and the identity and qualifications of any new management team. ISS then compares the activist's plan, nominees and management team to the incumbent's in order to arrive at a voting recommendation. In contrast, when an activist

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puts forward a short slate, ISS imposes a lower standard. In that case, ISS does not require a detailed action plan; nor is the activist required to prove that its plan is preferable to the incumbent's plan. Instead, the activist is required only to prove that board change is preferable to the status quo and that the activist's board nominees will add value to board deliberations (including by considering issues from a viewpoint different from that of the current board).

Participants in the proxy contest arena should also be aware that ISS will not always meet with issuers or activists to discuss their perspectives in a contest; whether it does so will depend on the issues at play and the relative market capitalization of the issuer. And, if ISS does meet with the parties, it has indicated that it will typically hold only one separate meeting with the respective representatives of the issuer and the activist, giving each side approximately one hour to convey its position.

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Targeting the CEO Through Board Change

It has long been argued by engaged investors that meaningful board change is an important prerequisite to a CEO's removal and reorienting the business. Win or lose, CEO change can often follow a proxy contest. However, one trend that has emerged in the United States is the targeting of the CEO for removal from the board as part of a short-slate proxy campaign. Although shareholders have no direct say over the appointment or removal of the CEO, targeting the CEO as part of a short-slate campaign or a withhold campaign (see "Activism Lite": The Withhold Campaign, below) provides an opportunity for a shareholder vote of no confidence in the targeted CEO. If the CEO is successfully removed from the board (or even if the CEO keeps his or her seat in a tight race), the board will come under significant pressure to replace the CEO.

This trend may, in part, be due to ISS's lower standard for short-slate proxy contests (see ISS 2018 Proxy Contest Guidelines: Treatment of Special Situations, above). However, ISS has indicated that targeting a CEO is an unusual and significant factor worthy of careful consideration in a short-slate proxy contest; it is unclear how much additional weight ISS ascribes to this factor because it is not discussed in its published proxy contest guidelines.[111]

"Vote Buying" Under CSA Review: Soliciting Dealer Fees Expected to Be Dead in Proxy Contests

In April 2018, the Canadian Securities Administrators (CSA) published Staff Notice 61-303 and Request for Comment – *Soliciting Dealer Arrangements*,[112] requesting comments on the use of soliciting dealer arrangements in proxy contests and corporate transactions to determine whether additional guidance or rules would be appropriate. The comment period has since closed, and the CSA received numerous responses from industry participants. The comments are unanimous in their disapproval of the use of soliciting dealer arrangements that involve a "success fee" payable only if the securityholder votes a certain way in a proxy contest.

"Soliciting dealer arrangements" generally refers to agreements entered into with one or more registered investment dealers pursuant to which the dealers are paid a fee for each security successfully solicited to (i) vote in connection with a matter requiring securityholder approval or (ii) be tendered to a takeover bid.

The use of soliciting dealer arrangements first gained prominence in the context of takeover bids to encourage shareholders to tender their shares to an offer. In that context, these arrangements were relatively uncontroversial. Soliciting dealer groups have also been formed in the context of M&A transactions structured by way of plan of arrangement, although in practice their usage tends to be less frequent. The extension of these arrangements to the proxy contest arena received significant attention when Agrium Inc. used the strategy to help elect its slate of director nominees in defence of a proxy contest launched by JANA Partners LLC in 2013. In that contest, Agrium agreed to pay the soliciting dealers a commission for each share voted in favour of its nominees, a tactic that was heavily criticized by institutional shareholders, corporate governance watchdogs and the media. Similar criticism was levied against the use of soliciting dealer arrangements by Liquor Stores N.A. Ltd. in defending the proxy contest launched by PointNorth Capital Inc. in 2017. PointNorth applied to the Alberta Securities Commission (ASC) seeking an order to halt the arrangements, but the ASC declined to intervene on the basis that soliciting dealer arrangements were not expressly prohibited under law and the practice was not clearly abusive to capital markets.[113]

The CSA's request for comment signals the regulators' re-evaluation of the appropriateness (or inappropriateness) of these arrangements. In its Staff Notice, the CSA suggests that soliciting dealer arrangements raise securities regulatory issues, as well as public interest questions that may need to be addressed. In particular, from the perspective of issuers, they raise questions relating to the integrity of the tendering process and the securityholder voting system – foremost among them being their potential for use to entrench an incumbent board and management. Soliciting dealer arrangements also raise concerns under the Investment Industry Regulatory Organization of Canada (IIROC) rules and dealers' ability to manage potential conflicts of interest and comply with proxy solicitation rules.

While comments submitted in response to the Staff Notice remain under CSA review, we anticipate regulatory guidance being released that will, effectively, prohibit the use of soliciting dealer arrangements in the proxy contest arena. Further details about the Staff Notice are available in Davies' April 2018 bulletin, *CSA Reviewing and Seeking Comments on Soliciting Dealer Arrangements in Proxy Contests and Corporate Transactions*.[114]

ESG and the Push for Diversity

Environmental, social and governance (ESG) issues continue to be an area of focus for responsible and active-passive investors, as well as for traditional activists. In recent years, traditionally passive investors such as The Vanguard Group Inc., BlackRock Inc. and State Street Global Advisors Inc., as well as a number of pension funds, have published guidance on their ESG priorities and have become more active through behind-the-scenes engagement on ESG issues. Such investors are also prepared to go public and openly target specific issuers, as exemplified by the public letter by JANA Partners & CalSTRS to Apple Inc. (discussed below), and if necessary to exercise their vote in opposition to management.

In our experience, boards and management are also giving more thoughtful consideration to ESG matters as these issues become mainstream. They are willing to engage in dialogue outside the spotlight, understanding that some ESG issues can represent a new perspective that can lead to enhancements in shareholder value over the long term.

As discussed in chapter 2, Looking Through the Gender Lens: Diversity and Harassment in the Era of #MeToo, one of the most prominent ESG issues is the continuing push to increase gender diversity in the boardroom and to implement related policies to foster gender diversity. In his 2018 letter to CEOs, Larry Fink, chairman and CEO of BlackRock, emphasized the importance of a diverse board.

A number of activists have elevated ESG to either a secondary or a fundamental component of their investment analysis, and actively screen for a lack of board diversity. In turn, some activists are also focusing on gender diversity as a key component of assembling an alternative slate in proxy contests. We fully expect this issue will continue to gain prominence in both Canada and the United States.

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Spotlight: Ides Capital Female-Led Activist Fund

Symbolic of the push for diversity, Ides Capital Management LP, launched in 2015 by Dianne McKeever, became the first U.S. activist hedge fund run by a woman. Under McKeever's leadership, Ides focuses on small and mid-capitalization public companies in seeking to constructively engage with management and boards to improve corporate governance practices and to implement changes that drive long-term value. Adopting the premise that weak governance practices, including a lack of diversity, frequently coincide with poor valuations, Ides has successfully campaigned to increase boardroom diversity. In 2016, Ides effected board change at U.S. wireless company Boingo Wireless, adding three directors (including one female nominee) to a board that McKeever's proxy campaign had characterized as "stale, pale and male."[115] This year, Ides is reported to have been at least partially responsible for the addition of a female independent director to the board of U.S. technology company AstroNova Inc.[116]

While female-led activist funds remain rare and women have yet to form a real presence in the activism space, we expect that gender, and diversity more generally, will remain an increasingly important issue in proxy campaigns as each side attempts to position itself as best to secure shareholder support.

Letter from JANA Partners & CalSTRS to Apple Inc.: Pushing Companies to Become Better Corporate Citizens

Earlier this year, JANA Partners LLC, a U.S. activist investment firm, and the California State Teachers' Retirement System (CalSTRS), a U.S. pension fund, launched an unconventional activist campaign against Apple Inc. in which they asked the technology giant to offer parents more choices to ensure that young consumers use Apple products in an optimal manner. JANA and CalSTRS, which collectively own a $2-billion equity position in Apple, sent the company an open letter on January 6, 2018, presenting their "social good" campaign as a means of enhancing long-term value for all shareholders and generating goodwill with parents and the next generation of customers.[117]

The letter outlines the growing body of evidence that social media use may have unintentional negative consequences for children and teenagers; it argues that it is both unrealistic and a poor long-term business strategy to expect parents to fight the battle of managing their children's technology use alone. The letter asserts that Apple has a responsibility to ensure that its devices are being used optimally and that Apple's limited parental controls are insufficient because they generally require parents to choose between shutting down or allowing full access to various tools and functions.

To address the problem, JANA and CalSTRS suggested that Apple convene a committee of experts to help study the subject, enhance mobile device software so that users can choose age-appropriate settings and assign a high-level executive to monitor the issue. Apple promptly responded to the letter by highlighting the existing parental controls built into iOS and revealing plans to add new features in the future to improve these tools.[118] At its Worldwide Developer Conference in early June, Apple debuted tools to combat technology addiction, including a "Do Not Disturb at Bedtime" feature, grouped notifications and the option of receiving a report on recent device usage. JANA has since commended Apple on its leadership and commitment to acting responsibly and called the new tools a clear win for parents and families, as well as for shareholders. JANA will be reviewing the details of the new tools, and the firm has noted that Apple's follow-through will be important.[119]

Given Apple's seemingly positive response to the letter, we may see more of these types of "social good" activist campaigns in the future. However, it is not yet clear whether social good campaigns will become a growing trend or enjoy similar success, particularly when the impact on a company's bottom line is uncertain.

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"Activism Lite": The Withhold Campaign

With respect to the relatively smaller companies that populate Canadian markets, larger investors may find that the investment itself is not worth the high cost of a proxy contest. If their efforts to achieve management or board change through negotiations fail, they may ultimately exit the stock or resort to a withhold campaign. We are seeing increased appetite by both activists and traditional long-only investors to either threaten or engage in withhold campaigns – that is, public campaigns to encourage shareholders to withhold their votes on the election of one or more director nominees of an issuer.

There are many reasons why a withhold campaign can be an attractive course of action. A withhold campaign is a flexible tool in the hands of an investor that wishes to target a specific issue without necessarily causing broad disruption in the boardroom. For example, an investor could mount a withhold campaign against the chair of a nominating committee that has demonstrated intransigence on the issue of gender diversity; or an investor could target the chair of the compensation committee to express concern over compensation decisions. A withhold campaign can be tailored to target specific individual directors with a concise narrative that can be difficult to rebut. And such a campaign does not require the investor to advance an alternative nominee, thus depriving the issuer of a target to take aim at.

A withhold campaign can be mounted at significantly less expense than a full-fledged proxy contest, thus representing a potentially cost-effective means of expressing shareholder discontent. A withhold campaign also does not need to be successful to count as a win. The fact that the campaign is initiated and enjoys some takeup, without necessarily unseating a director, can stimulate the desired engagement by the board on the investor's issue. And with the anticipated implementation of "true" majority voting at Canadian federally incorporated public companies in the next 18 to 24 months (see chapter 9, CBCA Amendments Will Implement True Majority Voting), the success of withhold campaigns may be enhanced.

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Our Take: Considerations for Boards and Management

It may sound trite, but the message for boards and management in 2018 remains consistent with prior years – be your own activist. A number of measures can be proactively undertaken by issuers to make their profile less attractive to activist investors – here are our top five tips:

1 Review and Assess

Give careful thought to possible areas where activists may see existing or emerging value-creation opportunities or vulnerabilities, such as negative trends or your ESG profile (including your history of board refreshment or lack thereof). Develop a cogent analysis regarding each point of vulnerability and action that an activist may advocate for; then determine which actions should be undertaken, which should not and why. Understand the possible arguments "for" and "against" those actions.

2 Refresh and Diversify

Implement a formal board refreshment process if you have not already done so. Lengthy board tenures, gaps in director expertise and a lack of board diversity are increasingly common targets of investors. Moreover, regular board assessments, thoughtfully managed refreshment and enhanced diversity on boards are generally viewed as governance steps that enhance shareholder value, while sending a positive signal to your shareholders and the market.

3 Plan for Succession

Create a succession plan for the CEO and keep it up to date. As discussed in prior years' *Davies Governance Insights* reports, the unexpected loss of a CEO or an accelerated need to replace the CEO can have significant adverse consequences for an issuer and an unprepared board.

4 Engage

Avoid treating shareholder engagement as a pro forma exercise or assuming the support of key shareholders. Develop profiles of key institutional and other shareholders and become familiar with their voting policies and past history. Meet with significant shareholders, explain your business strategy and plans, understand their concerns, assess their support for management and the board, and, where suitable, proactively communicate about identified vulnerabilities, explaining the management and board's position. The format of the engagement and who attends those meetings will, in each case, depend on the nature of the investor and the issues to be discussed.

5 Broadly Communicate

Avoid treating continuous disclosure as boilerplate or a form-checking exercise. In some cases, investors have criticized an issuer not because its practices or strategies were poor, but rather because those strategies and approaches have been poorly communicated. Use continuous disclosure as a platform to clearly articulate to shareholders not only the issuer's results and strategies, but also its board processes, board refreshment exercises, plans and accomplishments on ESG and other significant matters.

Additional information about other issues and trends in shareholder activism can be found in our report *Davies Shareholder Activism and Proxy Contests: Issues and Trends.*[120] Additional data concerning prior years' trends in activism are also available in our *Davies Governance Insights 2017* and *Davies Governance Insights 2016.*[121]

CHAPTER 06

Ten Years Later: Director Duties and Implications of the *BCE* Case

The year 2018 marks the 10-year anniversary of the Supreme Court of Canada's groundbreaking decision in *BCE Inc. v 1976 Debentureholders (BCE)*.[122] In this chapter, we reflect on what would have been the largest corporate buyout in Canadian history and discuss how the Supreme Court of Canada's ruling on the transaction fundamentally altered the landscape for public company directors in Canada today. We end with some unanswered questions regarding what it means to be a "good corporate citizen" and offer practical guidance for directors who are contemplating change of control transactions.

The BCE Transaction

Bell Canada Enterprises (BCE), the largest communications company in Canada, had large cash flow and strong financial indicators, but its share price was disappointing. BCE's board of directors was considering strategic alternatives, including a share repurchase, converting to an income trust and the possibility of a privatization or leveraged buyout. There were rumours that various private equity consortiums were arranging financing to initiate bids for BCE and, in April 2007, Ontario Teachers' Pension Plan (Teachers') filed a Schedule 13D report with the U.S. Securities and Exchange Commission, changing its status from passive to active, publicly putting BCE in play.

The BCE board decided that it was in the best interests of the company to create a carefully managed auction process. It established a strategic oversight committee comprising four independent directors and invited competing bidding consortiums to make offers. When BCE announced the auction process, the market price of the debentures of Bell Canada (a wholly owned subsidiary of BCE) fell significantly owing to the market's expectation that the substantial additional debt required to complete a leveraged buyout would have a negative impact on Bell Canada's credit rating.

Three groups submitted offers; all of the offers involved large amounts of debt for which Bell Canada would be liable. The BCE board ultimately accepted the offer of the Teachers' consortium as being in the best interests of BCE and Bell Canada. Under the transaction agreement, all of BCE's common shares would be acquired at a price of $42.75 per common share, representing a 40% premium over the market price at the time.

The transaction was structured as a court-supervised plan of arrangement under the *Canada Business Corporations Act* (CBCA), which required a shareholder vote as well as a court order confirming that the plan was "fair and reasonable" to the parties whose rights were being arranged. BCE shareholders overwhelmingly approved the transaction by 97.93%.

Yet at the fairness hearing, Bell Canada's debentureholders challenged the plan of arrangement and also commenced oppression proceedings on the basis that their rights and interests as creditors of Bell Canada had been unfairly prejudiced or disregarded. They pointed to the fact that the market value of their debentures decreased by 20% and that the debentures would likely lose their investment-grade status. BCE, on the other hand, argued that the debentureholders' legal interests had been considered and that they could not assert any reasonable expectations beyond their contractual rights contained in their trust indenture.

At trial, the Québec Superior Court dismissed the debentureholders' legal challenge under the oppression remedy and approved the arrangement as being fair and reasonable under the CBCA. However, on appeal, the Québec Court of Appeal held that the plan of arrangement was not fair and reasonable to the debentureholders and should not have been approved. Although the Court of Appeal did not address the oppression remedy directly, it ruled that the directors should have considered the debentureholders' reasonable expectations and contemplated alternatives that would have mitigated the economic harm caused by the transaction.

The Supreme Court of Canada's Decision

Ultimately, on June 20, 2008, the Supreme Court of Canada (SCC or Court) ruled in favour of BCE, overturned the Court of Appeal's decision and upheld the plan of arrangement. And while the SCC's decision released in December 2008 clarified some of the considerable uncertainty regarding the scope of directors' duties in change of control transactions and the interaction between the oppression remedy and the "fair and reasonableness" test for plans of arrangement, the SCC decision did leave some loose ends.

Five key points emerged from the SCC decision:

1. Fiduciary duty of directors. The SCC decision in some respects clarified the fiduciary duty of directors, upholding the principle that the fiduciary duty is owed not to any particular constituency (e.g., shareholders), but to the corporation as a whole. The Court described the fiduciary duty of directors as a "broad, contextual concept" with an eye to the long-term best interests of the corporation. Less helpful than providing clear guidance on how that duty was to be satisfied, the Court held that the "fiduciary duty of the directors is a broad, contextual concept. It is not confined to short-term profit or share value. Where the corporation is an ongoing concern, it looks to the long-term interests of the corporation. The content of this duty varies with the situation at hand."

2. Conflicting interests among stakeholders. Where conflicts between constituencies exist, as they did in *BCE*, the board must resolve them while meeting its fiduciary duty to the corporation itself. In doing so, directors must treat individual affected stakeholders "fairly and equitably." There is a "need to treat affected stakeholders in a fair manner, commensurate with the corporation's duties as a responsible corporate citizen." This does not mean that every stakeholder will be satisfied with a corporate decision or transaction, but it is critical that their interests be considered. In *BCE*, the SCC held that the debentureholders' interests were fairly considered by the board, even though the result was not favourable to them. That said, in decisions such as the one faced by the BCE board, the interests of shareholders do not necessarily supersede all other interests. The Court was clear

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in stating that the consideration of conflicting interests depends on the circumstances. And while the Court suggested that directors may consider the impact of change of control transactions and other corporate decisions on affected stakeholders, it did not provide clarity on how to balance those competing interests. Nor did it elaborate on the circumstances in which directors must consider the impact of a corporate decision on affected stakeholders. In the end, directors' decisions will be judged with the benefit of hindsight on the basis of the particular situation faced by the directors.

3. Directors' duties in change of control transactions. The SCC recognized that directors can discharge their duties by maximizing shareholder value in a change of control transaction but, importantly, the decision does not impose a duty upon directors to maximize shareholder value. Instead it leaves to the discretion of the board the determination of the appropriate allocation of expected benefits among stakeholder groups. Although there will undoubtedly be circumstances in which the best interests of the corporation will be clearly aligned with the maximization of shareholder value, the SCC decision leaves open the possibility that the highest value will not always be in the best interests of the corporation.

4. Oppression remedy. The SCC rejected the Court of Appeal's analysis, which had subsumed the oppression remedy claim within the analysis of whether the arrangement was fair and reasonable. The Court highlighted the different questions and burdens involved in each case. In assessing a claim for oppression, the Court set out a two-part test: (i) Does the evidence support the reasonable expectation asserted by the claimant? and (ii) Does the evidence establish that the reasonable expectation was violated by conduct that is "oppressive" or "unfairly prejudicial" or that "unfairly disregards" a relevant interest? Factors that a court will consider in determining whether the aggrieved stakeholder has an "objective and contextual" reasonable expectation include the following:

- general commercial practice
- the nature of the corporation
- the relationship between the parties
- past practice
- steps the claimant could have taken to protect itself
- representations and agreements
- the fair resolution of conflicting interests between corporate stakeholders.

In *BCE*, the SCC held that BCE's public statements regarding the debentures' investment-grade rating were accompanied by explicit safe harbours that precluded investor reliance on such statements. The Court also noted that the debentureholders were sophisticated parties who negotiated lengthy and complex trust indentures and could have contracted for voting rights in the context of an arrangement. Ultimately, the Court concluded that the debentureholders did not have a reasonable expectation that the investment-grade rating of their debentures would be maintained. And while the Court did agree that the debentureholders had a

reasonable expectation that their economic interests would be considered by the directors, this expectation had been fulfilled.

5. Business judgment rule. The SCC affirmed the business judgment rule, stating that so long as the board makes a decision "within a range of reasonable choices," a court would likely defer to the board's business judgment. In this respect, the Court's decision is a board-friendly one, which comes as some relief to directors as they try to balance competing interests in carrying out their duties in the absence of clear guidance on how to balance those interests and what weight to accord the shareholders' interests relative to other affected stakeholders in the context of a change of control transaction.

Being a "Good Corporate Citizen" in the Aftermath of *BCE*

The decision in *BCE* cleared up some of the uncertainty created by the line of prior Canadian and U.S. cases concerning directors' duties and compounded by the Court of Appeal's earlier decision and reasons in *BCE*; however, it also left some questions unexamined or unanswered. For example, what does it mean for directors to act in the bests interests of the corporation "viewed as a good corporate citizen" – important words of the SCC that have since left many questioning their intended meaning and implications.

Directors today face considerably more challenges in carrying out their duties and responsibilities, given the increased competitiveness, globalization, regulatory burdens, technological changes, and growing investor expectations and engagement. Layered on top of this is the pronounced focus on "good corporate governance" generally. Good corporate governance is certainly not limited to the imperative of enhancing shareholder value, which is only one of many aspects of good governance. Directors must balance the interests of many different stakeholder groups, including shareholders, employees, suppliers, creditors, consumers, governments and the environment. They must also manage the different investment time horizons imposed by various investors. And increasingly, they face pressure to ensure that, having regard to the longer-term interests of the corporation, ethical and sustainable practices are built into their strategies and plans.

Directors must balance the interests of many different stakeholder groups, including shareholders, employees, suppliers, creditors, consumers, governments and the environment.

The practical effect of the SCC's decision in *BCE* is likely that directors need to assess a range of competing interests of affected stakeholders in carrying out their fiduciary duties and exercising their business judgment to avoid statutory and common law liability for, or remedies in respect of, their actions. Over time, it is clear that courts and legislators have, in construing directors' duties, taken into account evolving expectations of investors and other stakeholders and societal expectations at large. In the context of some corporate transactions, this may also require directors to go one step further by implementing specific protections for affected stakeholders to ensure they are being treated fairly and equitably and to evidence due consideration being given to their interests. Given the complexities associated with carrying out directors' duties, in all cases appropriate legal advice should be obtained.

Our Take: Discharging Directors' Duties in Corporate Transactions

Although the SCC gave the green light for the transaction to proceed, ultimately the BCE deal fell apart. Credit markets were rapidly deteriorating around the world and, in late 2008, KPMG refused to provide a positive solvency opinion for BCE, which was a requirement in the amended agreement between Teachers' and BCE. Nonetheless, the Court's decision continues to provide useful guidance for public company directors who are responsible for overseeing significant change of control transactions. The following best practices should be top of mind:

1 Obtain expert advice from legal and financial advisers during the sale process

These advisers should be actively involved in assisting the board and/or special committee to formulate its views and recommendations. Although the directors may not all be qualified to independently analyze the findings and recommendations of an adviser, the board members should satisfy themselves that an adviser's review has been thorough and complete. The board should be proactive and not completely delegate the review and evaluation of the transaction and possible alternatives to its advisers.

2 Carefully and diligently consider alternatives and impacts

In conducting their analysis, directors should consider not only the substantive merits of the proposed course of action but also the proposed course of action relative to the alternatives that may be available to achieve the best interests of the corporation (having regard to the shareholders and other affected stakeholders) in the circumstances. The board and its advisers should conduct a careful review of the information and documents relevant to the matters it is considering. It is important to ensure that the directors have a reasonable time within which to review all relevant documents relating to any proposed transaction.

3 Create an informed and independent process that would easily allow a court to defer to the board's decision-making process (using the business judgment rule)

Each director should at the outset declare any interest she or he may have in any proposed course of action (including in any proponent or critic of that course of action) and the nature of any relationship or future prospect with a potential acquirer or other party (or related party) to a transaction under consideration. The existence of a director's interest that may conflict with the exercise of independent judgment can often be considerably more subtle a matter than formal affiliation with a contractual counterparty. The board should gather, and review, all relevant information reasonably available pertaining to the matters within its mandate. In this regard, reliance should not be placed exclusively upon management. As fiduciaries, directors are required to prudently inform themselves, prior to making a decision or recommendation, of all material information reasonably available to them.

4 Question, debate and discuss important, difficult and complex decisions around the boardroom table

Allow sufficient time for proper consideration and discussion. Courts may be critical of the decisions made by a board that has not actively participated, directly or through advisers, in reviewing or structuring proposed courses of action that it is called upon to consider, particularly in cases involving contests for control. The board may work closely with management, and may request that management conduct negotiations and other work concerning the recommended course of action, but should actively direct and supervise such actions.

5 Carefully document deliberations and advice sought and received

Minutes should be kept of all meetings of the board and/or special committee in sufficient detail to show the manner in which the board or committee fulfilled its mandate and to summarize the advice it received. Any special committee should summarize all of its deliberations and conclusions in a report to the full board.

CHAPTER 07

Executive and Director Compensation Trends and Issues: A Three-Year Review

Canadian shareholders and institutional investors continue to express strong support for executive compensation programs that effectively align management incentives and company performance. One emerging trend from the results of "say-on-pay" votes has been a shift in executive compensation practices toward long-term incentive plans (LTIPs). Canadian issuers are also implementing longer vesting periods for LTIP compensation, indicating increased shareholder preference for long-term objectives and investment horizons. This year, we analyze three-year trends in executive and director compensation, as well as correlations between certain demographic criteria and compensation. In addition, we review changing director compensation models and the effect of these changes on director-shareholder engagement. We also examine the new pay ratio rules implemented in the United States and recently enacted in the United Kingdom. Could pay ratio disclosure requirements for Canadian issuers be next?

"Say-on-Pay" Trends in Canada

The adoption of "say-on-pay" by issuers on the TSX Composite and SmallCap indices has continued to increase over the past three years. In 2018, 48% of TSX-listed issuers held say-on-pay votes, compared with 45% in 2017, 44% in 2016 and 34% in 2015. Although the prevalence of say-on-pay votes has increased among the broad cohort of TSX Composite and SmallCap issuers, say-on-pay votes by TSX 60 issuers have slightly declined. The percentage of TSX 60 issuers adopting say-on-pay votes fell to 78% in 2018, compared with 80% in 2017 and 83% in 2016. Despite this modest decline among TSX 60 issuers, shareholders continue to advocate for annual input on executive compensation practices, as demonstrated in the case of Crescent Point Energy Corp.'s second failed say-on-pay vote discussed below.

In 2018, as in past years, a majority of shareholders of Composite and SmallCap companies voted in favour of proposed executive compensation packages when exercising their say-on-pay vote, with the average support level being 92%. Overall, say-on-pay results in 2018 have been consistent with prior years, both in terms of average support levels and the occurrence of high-profile failures. The percentage of Composite and SmallCap issuers achieving say-on-pay approval greater than 85% increased from 87% in 2017 to 91% in 2018, and companies achieving approval greater than 95% decreased from 47% in 2017 to 38% in 2018.

Proxy advisory firms continue to wield significant influence in determining the outcome of say-on-pay voting. Misalignments between pay and performance continue to be a key factor behind the proxy advisory firms' recommendations "against" issuers' approaches to executive compensation.

In 2018, there was a year-over-year decline in the number of negative recommendations from Institutional Shareholder Services, Inc. (ISS) and Glass Lewis & Co. (Glass Lewis) to TSX 60 issuers, largely as a result of issuers undertaking increased shareholder engagement and other remedial steps to proactively address perceived executive compensation issues. ISS recommended votes "against" in only two say-on-pay votes among TSX 60 issuers, and Glass Lewis did not issue a negative recommendation with respect to any say-on-pay votes among TSX 60 issuers.[123]

Overall, say-on-pay results in 2018 have been consistent with prior years, both in terms of average support levels and the occurrence of high-profile failures.

Spotlight: Crescent Point's Failed Say-on-Pay Vote

Crescent Point Energy Corp. came under scrutiny in 2018 for its second unsuccessful say-on-pay vote in three years, which failed largely as a result of perceived misalignment between company performance and executive compensation. Cation Capital Inc., an activist shareholder, initiated a proxy battle for 4 out of 10 board seats, arguing that Crescent Point's executive compensation practices were misaligned with company performance. Cation pointed out that despite Crescent Point's stock price dropping by nearly 76% since 2013, top executives had received $93.5 million in compensation over the same period.

ISS and Glass Lewis provided conflicting voting recommendations to Crescent Point's shareholders. ISS supported two of the four board members nominated by Cation and recommended voting "against" Crescent Point's say-on-pay resolution because it agreed with Cation's proposition that new leadership would help Crescent Point with its profitability and compensation and capital issues. Glass Lewis, on the other hand, despite reservations, supported all of Crescent Point management's recommendations and recommended voting "for" the say-on-pay resolution.

Ultimately, Crescent Point succeeded in the proxy battle because shareholders supported management's board nominees, but failed to secure majority shareholder approval on the say-on-pay vote. Although say-on-pay votes are not binding, failed votes or relatively lower levels of support tend to have a significant impact on an issuer's compensation programs and strategy. Crescent Point subsequently announced capital budget cuts amounting to $25 million and amendments to its executive compensation plan to further align pay with performance. Notably, following the failed say-on-pay vote, Crescent Point's 17-year CEO, Scott Saxberg, stepped down. Since the results were publicly announced, Crescent Point's share price has rebounded slightly, perhaps indicating some degree of shareholder satisfaction.

Redesigning Executive Compensation in Response to Investor Pressure

Increasingly, issuers are engaging major institutional shareholders and proxy advisory firms to elicit greater input regarding their executive compensation practices. Currently, about 40% of TSX 60 issuers voluntarily disclose details of director-shareholder engagement activities, compared with 22% in 2017.[124] Moreover, 50% of TSX 60 issuers have disclosed their adoption of formal, director-shareholder engagement programs, most of which involve investor relations teams. Learning from failed say-on-pay votes in 2017, issuers are taking proactive steps to prepare for their annual say-on-pay votes, including sometimes materially modifying their disclosure, enhancing the compensation discussion and analysis, and changing components of their respective executive compensation programs.[125]

In recent months, some TSX-listed issuers have publicly announced amended compensation plans in response to investor pressure. In addition to Crescent Point, a number of large Canadian companies, including Bombardier Inc., Tricon Capital Group Inc. and Magna International Inc., redesigned their executive compensation strategies after pushback from major shareholders. Generally, these changes were intended to better align executive compensation with stock and company performance.

However, investor pressure does not always result in changes to executive compensation arrangements. In June 2018, Hudson's Bay Company's (HBC's) largest institutional investors, including Ontario Teachers' Pension Plan (Teachers') and British Columbia Investment Management Corp. (BCIMC), opposed a $54-million compensation package for HBC's executive chairman. Teachers' and BCIMC viewed the pay package as disproportionate in light of the fact that HBC had posted losses in excess of $500 million in each of the two prior financial years and HBC's share price was stagnant at less than half its mid-2015 levels. Despite vocal objections by some of Canada's largest institutional investors and Glass Lewis's recommendation against the package, 70% of HBC shareholders voted in favour of the compensation package, with no amendments.[126]

In June 2018, BlackBerry Ltd. shareholders voted in favour of an executive pay package that could allow its CEO to earn more than US$400 million over the next five years. Half of the equity awards granted are tied to performance-based conditions, while the other half are time-based grants. The performance-based awards place significant pressure on the CEO to turn around company performance and directly align CEO compensation with absolute shareholder return, requiring the share price to rise from US$16 to US$20 between 2019 and 2022. The compensation

Increasingly, issuers are engaging major institutional shareholders and proxy advisory firms to elicit greater input regarding their executive compensation practices. Currently, about 40% of TSX 60 issuers voluntarily disclose details of director-shareholder engagement activities, compared with 22% in 2017.

package is lucrative compared with those of similar companies in the Canadian market. As a result, Glass Lewis recommended that shareholders vote "against" BlackBerry's say-on-pay resolution. However, despite these circumstances, 90.6% of shareholders voted "for" BlackBerry's approach to executive compensation, suggesting that the market may be supportive of compensation plans that are tied to performance and align leadership incentives with long-term shareholder interests, even where seemingly high in real dollar terms.[127]

CEO Compensation Trends: Three-Year Review

CEO TOTAL PAY

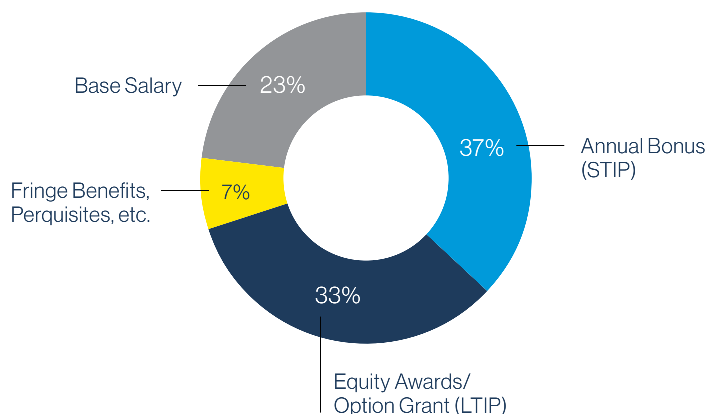
In 2018, the average total pay for CEOs of TSX 60 companies was 2% lower than in 2017, and 6% lower than in 2016. On the other hand, in 2018, the average total pay for CEOs of Composite Index companies was 3% higher than in 2017, but still 2% lower than in 2016. CEOs of companies on the SmallCap Index experienced a similar trend, with average total pay 10% higher in 2018 than in 2017, but still 2% lower than the average total pay in 2016. Across all three indices, despite slight reductions in base salary, bonuses and perquisites, average total pay for CEOs increased by 1% in 2018 compared with 2017 – primarily due to an increase in long-term incentive awards.

CEO PAY MIX

The average pay mix for TSX 60 CEOs in 2018 has remained fairly consistent with the 2017 and 2016 averages. As shown in Figure 7-1, base salary in 2018 constituted 23% of total pay, up from 22% in 2017, but still slightly lower than 24% of total compensation in 2016. In 2018, bonuses constituted 37% of total pay, consistent with 2017 and 2016. The proportion of long-term incentives awarded to TSX 60 CEOs has increased to 33% in 2018, from 31% in 2016 and 29% in 2017. In 2018, CEO compensation in respect of perquisites and fringe benefits declined.

In 2018, the average total pay for CEOs of TSX 60 companies was 2% lower than in 2017, and 6% lower than in 2016. On the other hand, in 2018, the average total pay for CEOs of Composite Index companies was 3% higher than in 2017, but still 2% lower than in 2016.

FIGURE 7-1: CEO COMPENSATION TOTAL PAY MIX – TSX 60, 2018



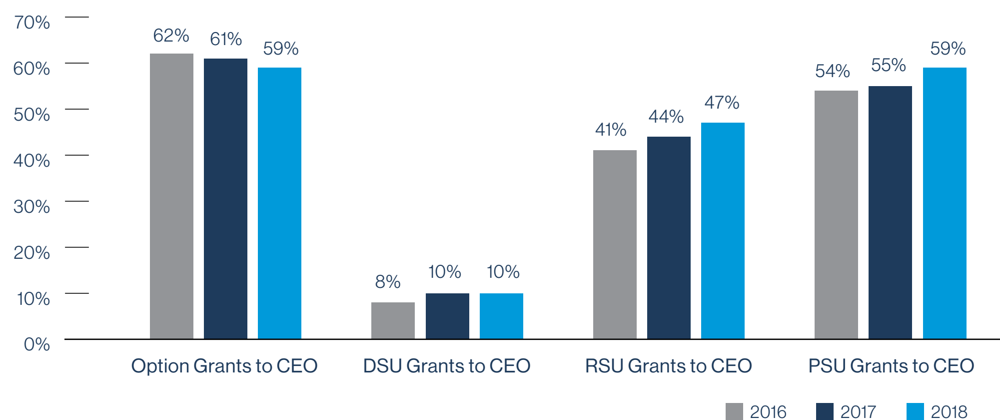
Performance share units are increasingly becoming the LTIP vehicle of choice for TSX-listed issuers across the board.

CEO LTIP COMPOSITION AND METRICS

For Composite Index issuers, the combination of equity vehicles for LTIPs varies depending on the size of the organization, although performance share units (PSUs) are increasingly becoming the LTIP vehicle of choice for TSX-listed issuers across the board. For smaller companies, restricted stock units (RSUs) are more prevalent, whereas larger organizations tend to favour stock options and performance-based vehicles. In addition to company size, the combination of LTIP vehicles used by issuers is also driven by economic cycles, growth patterns and the cyclical nature of various industries. For instance, stock options are more common in the consumer discretionary sector, whereas companies in the utilities, telecommunication and healthcare industries tend to favour PSUs. However, companies in the real estate and information technology sectors place a greater emphasis on RSUs and have been slower in migrating to performance-based equity programs.[128] Companies in the consumer staples and financial sectors favour blended LTIP programs, using all three types of equity-based awards to compensate executives.[129]

TABLE 7-1: CEO LTIP VEHICLES – COMPOSITE INDEX ISSUERS

% of Companies on the Composite Index (2016 – 2018)



There is an increasing trend toward the use of longer-term LTIP vehicles.

As demonstrated in Table 7-1, over the last three years, the percentage of Composite Index issuers granting stock options to their CEOs has declined slightly, while a larger percentage of Composite Index companies have turned to granting RSUs and PSUs. Overall, a greater number of Composite Index companies are offering diversified LTIPs to CEOs, particularly favouring RSUs and PSUs. The use of deferred share units (DSUs) in LTIPs remained relatively constant between 2017 and 2018.

Over the past year, TSX 60 issuers have not significantly varied the mix of incentives in their CEO LTIP plans. PSUs constitute the bulk of LTIP compensation, representing slightly less than half of total LTIP compensation (46%). Stock options represent just over one-third (34%) of LTIP compensation. RSUs (18%) and DSUs (2%) make up the remainder. Compared with 2016, the use of PSUs has declined modestly (down 2% year over year) in favour of RSUs, which are up 3% year over year. DSUs and stock options have remained fairly constant.[130]

There is an increasing trend toward the use of longer-term LTIP vehicles.[131] The vesting periods for stock options are increasing and range between three and five years. Although three-year vesting periods remain the most common, larger issuers on the Composite Index are transitioning to four-year vesting periods.[132] Owing to Canadian tax law considerations, PSUs most commonly have a three-year vesting period. However, performance measurement vesting periods vary across companies depending on the particular performance metric employed:

- Where performance is measured by total shareholder return, a three-year performance measurement period is generally used.
- Where operational measures are used, a three-year average annual performance is employed, meaning that performance targets are reset and appraised annually, over a three-year period.[133]
- Where shorter performance measures are used, performance is commonly judged on an annual basis, but payout may be delayed for additional periods.

Among TSX 60 issuers, 53 disclosed the use of PSUs in 2017. As shown in Table 7-2, the following statistics summarize the various types of performance metrics that these companies used to award such units:[134]

- 68% of companies used more than one metric to assess performance, up from 55% in 2016.
- 74% of companies used relative or absolute total shareholder return as their primary performance metric, up from 66% in 2016. Metrics based on return and earnings performance were the next most commonly applied metrics.
- 11% of companies used operating performance metrics, down from 16% in 2016.
- 9% of companies used top-line revenue growth, up from 2% in 2016.[135]

Although relative total shareholder return remains the most common performance metric, over the last year there has been some movement toward the application of absolute performance metrics among TSX 60 issuers.[136] Specifically in the resource sector, institutional shareholders are advocating for greater emphasis on absolute performance measures to shift management focus from relative total shareholder return (measuring performance against competitors) to absolute shareholder return (generating consistent positive returns for investors).[137] Companies on the Composite Index using multiple metrics frequently combine shareholder return and operational return metrics when selecting performance measures.[138]

68%

of companies used more than one metric to assess performance, up from 55% in 2016.

74%

of companies used relative or absolute total shareholder return as their primary performance metric, up from 66% in 2016. Metrics based on return and earnings performance were the next most commonly applied metrics.

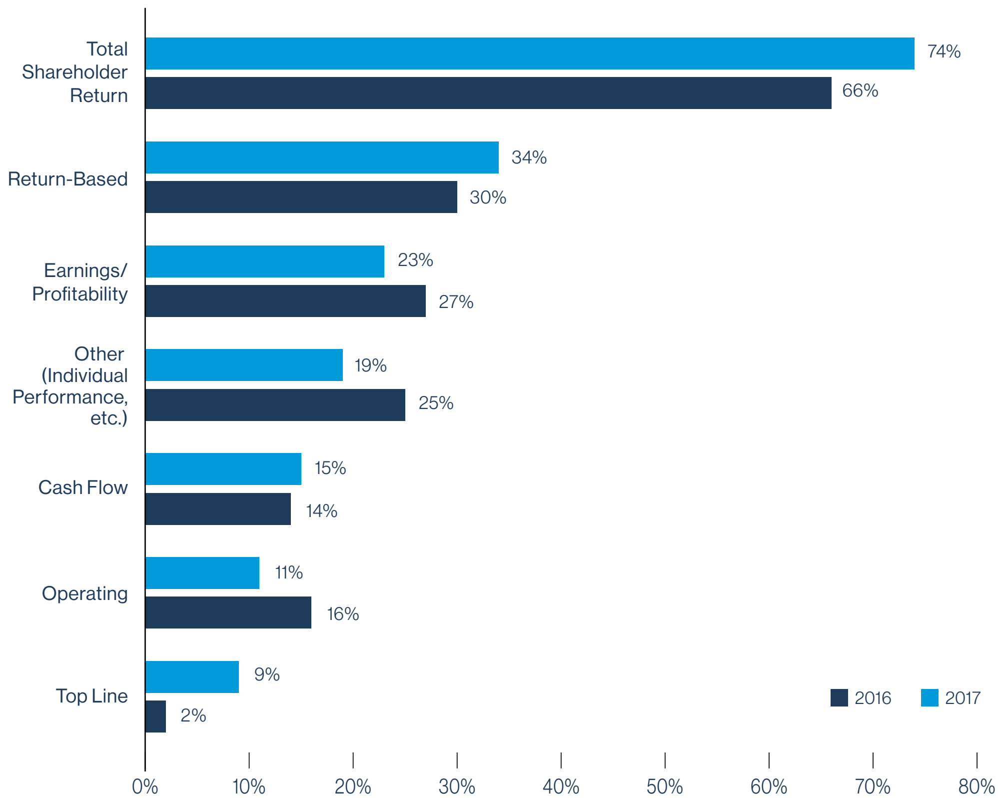
11%

of companies used operating performance metrics, down from 16% in 2016.

9%

of companies used top-line revenue growth, up from 2% in 2016.

TABLE 7-2: USE OF COMMON PERFORMANCE METRICS IN PSU PLANS – TSX 60 ISSUERS, 2016–2017



Source: Willis Towers Watson

Spotlight: Tricon and Magna Redesigned Compensation Programs

Recently, two prominent Canadian TSX-listed companies redesigned their executive compensation practices in an effort to better align compensation with executive performance and shareholder value.

In 2017, shareholders of Tricon Capital Group Inc. criticized the company's executive compensation structure for being out of sync with industry peers. The shareholders argued that Tricon's executive compensation structure was overly dilutive – especially in light of the company's maturity – and inconsistent with industry best practices.

As of 2018, Tricon's executives receive a modified compensation package with several features restructured to respond to shareholder concerns. Specifically, Tricon's new executive compensation structure reduces reliance on time-based vesting awards, establishes executive salary ranges, adopts share ownership guidelines for senior executives, features a redesigned Annual Incentive Plan (AIP) and introduces a non-dilutive PSU plan that vests on the basis of adjusted earnings per share.

The Tricon AIP underwent some of the most significant changes, including changes to the bonus metrics and structure. Instead of calculating the AIP pool through a fixed percentage of adjusted EBIDTA, the company now considers individual and collective executive performance. No more than 50%–60% of the bonuses comprise cash, and the remaining portion is paid out in the form of PSUs and stock options to better align pay and performance.

Magna International Inc. chose to redesign its compensation program for reasons similar to Tricon's. Previously, Magna's compensation strategy was to pay its executives a low base salary and maintain a pre-tax bonus pool. In 2017, the company introduced a new executive compensation program, which will apply to all executive officers by 2019. This new program maintains the low base salaries and bonuses based on profitability. However, it now includes PSUs that are awarded on the basis of return on invested capital and total shareholder return on Magna shares compared against a peer company group. These new elements reward long-term performance as opposed to short-term profitability.

STOCK OWNERSHIP GUIDELINES FOR CEOs

Despite the overall trend toward aligning executive compensation with shareholder value through performance-based compensation, the number of TSX-listed issuers that disclosed stock ownership guidelines for their CEOs declined in 2018, compared with both 2017 and 2016. In 2018, 71% of TSX-listed companies disclosed CEO stock ownership guidelines, compared with 81% in 2017 and 79% in 2016. This downward trend is present across all TSX indices and demonstrates a reversal from the increase between 2016 and 2017.

TABLE 7-3: PERCENTAGE OF TSX ISSUERS WITH CEO STOCK OWNERSHIP GUIDELINES

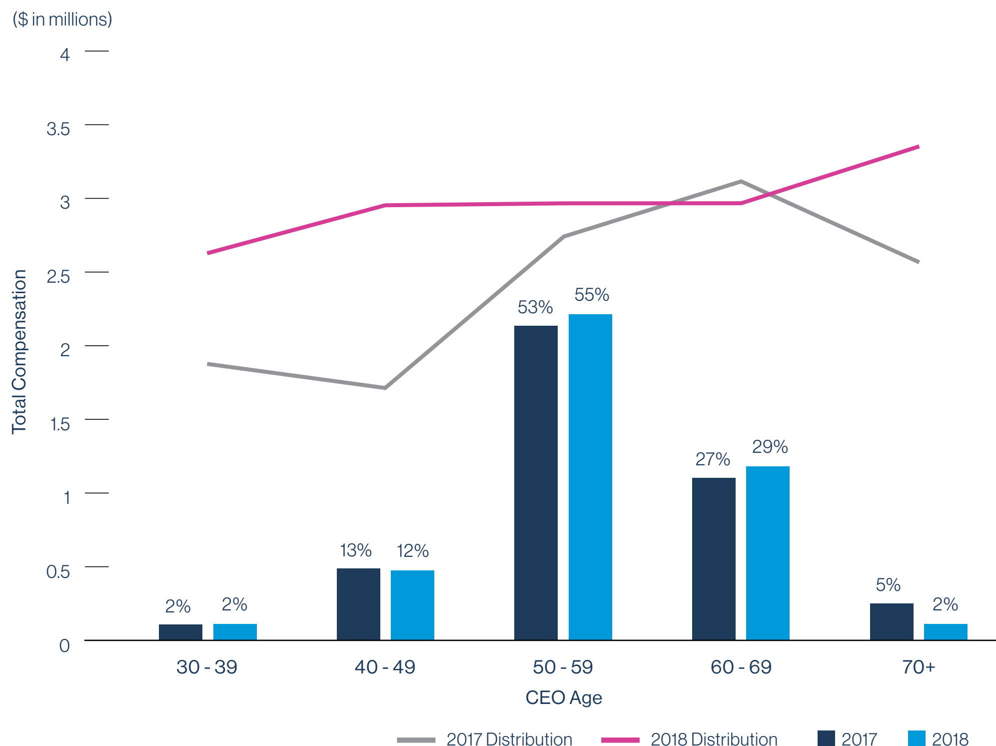
	2016	2017	2018
All TSX indices	79%	81%	71%
TSX 60	97%	97%	93%
Composite Index	90%	91%	86%
SmallCap Index	67%	70%	58%

CEO Demographics and Compensation

CORRELATION BETWEEN CEO COMPENSATION AND AGE

There is a strong correlation between age and the opportunity to be at the helm of a U.S. or Canadian public company. Of Composite Index CEOs, 55% are in their 50s, whereas 14% are under the age of 50, including only 2% under the age of 40. On the other hand, 31% of Composite Index CEOs are 60+ years of age, including 2% above the age of 70. With an average age of 56, Canadian CEOs are in line with their U.S. counterparts, who average 57 years of age.[139]

TABLE 7-4: AVERAGE TOTAL CEO COMPENSATION IN COMPOSITE INDEX BY AGE, 2017-2018



There has been a marked year-over-year weakening in the correlation between CEO age and compensation for companies on the Composite Index. In 2017, CEOs in their 50s earned approximately 37% more in total compensation than their counterparts in their 40s. In contrast, in 2018, CEOs in their 50s earned only 1% more in total compensation than CEOs in their 40s. A similar weakening in the correlation between CEO age and compensation exists for CEOs in their 60s relative to those in their 50s; the former earned, on average, 10% more than the latter in 2017, whereas the 2018 data reflect no difference in total compensation between these two age brackets.

CORRELATION BETWEEN CEO COMPENSATION AND TENURE

Length of tenure as a CEO does not appear to be strongly correlated to total compensation. In fact, CEOs who have served for only two years at their organization earn the highest median total annual compensation, which is 2.6% higher than the median total annual compensation earned by CEOs who have served for 10 years or more. However, it should be noted that this figure may be skewed by one-time signing bonuses or equity awards granted to newly appointed CEOs. Among the five longest-tenured CEOs at Composite Index companies, total annual compensation ranged between $0.5 million and $10.5 million. However, total annual compensation can be an illusory statistic because it does not account for the equity position that a CEO may hold. Depending on a company's pay philosophy, a CEO's strong equity stake in the company may be perceived as reducing the need for a strong performance-based compensation package, which may also explain the apparent lack of correlation between tenure and total compensation.[140]

CORRELATION BETWEEN CEO COMPENSATION AND GENDER

Gender diversity among CEOs of companies on the Composite Index is progressing very slowly, with only 3.0% of CEOs (or 7 of 231 CEOs) being female. Since 2016, no female CEO has led a company on the TSX 60. However, despite being few in number, female CEOs serve on some of the larger corporations on the Composite Index, with revenues in excess of $1 billion per annum. Two-thirds of female CEOs are employed in the utilities industry. Canadian female CEOs leading Composite Index companies range between the ages of 45 and 60, with a median age of 57. The female CEO demographic is similar in the United States, where women represent 5.6% of all CEOs.[141]

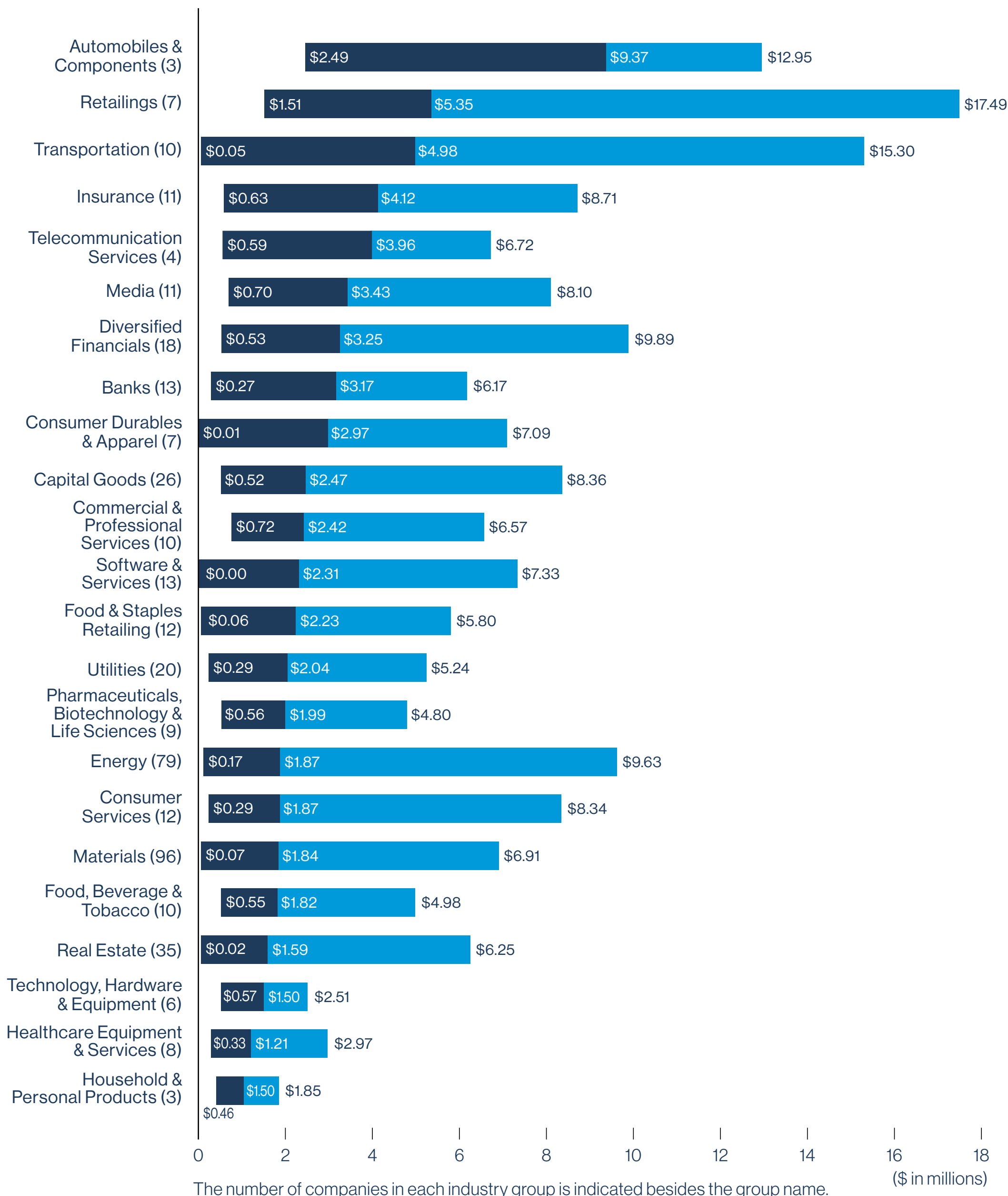
CEO COMPENSATION BY INDUSTRY

Total annual CEO compensation varies widely between and within industries. As shown in Table 7-5, in 2018, CEOs of companies in the automobile and components industry received the highest average annual total compensation, including base salary, bonuses and LTIP grants. The retail and transportation industries also posted high average annual total compensation for their respective CEOs, although, as with the automobile and mining industries, this average number was skewed by outlier values at the high end of the compensation range. In contrast, CEO compensation in the banking industry, while lagging other industries in maximum values, exhibited stronger clustering of compensation around the average, rather than influenced by single outliers. At the lower end of the range, CEOs in the real estate and materials industry received less compensation, on average, than their peers in other industries.

Human Resource Experience on Compensation Committees: It Matters

A key objective of executive compensation plans is aligning the interests of investors and management. Having compensation committees comprised of some directors with human resource (HR) expertise is important to achieving this objective. Employees, including executives, are complex resources for a company to manage. Individuals with HR expertise are skilled in human capital management, including the nuances of motivating employees, which results in more effective executive compensation plans that encourage the advancement of corporate goals.[142] As in the case of audit committees, which require appointed directors to have the necessary financial expertise, it is a best practice for directors appointed to compensation committees to have experience in

TABLE 7-5: TOTAL CEO PAY BY INDUSTRY – MINIMUM, MAXIMUM AND AVERAGE PAY, 2018



The number of companies in each industry group is indicated besides the group name.

executive compensation and human resource issues, as well as a strong understanding of the shareholders' and the company's overall compensation philosophies.

Director Compensation

DIRECTOR COMPENSATION MODELS

Across all Composite and SmallCap companies, there has been a continued trend toward flat-fee compensation for directors, away from the pay-per-attendance model, which, in 2015, was the primary model for compensating directors across more than two-thirds of those companies. In 2018, 55% of Composite and SmallCap issuers paid their directors on a flat-fee basis, up from 47% in 2017. There is also a correlation between company size and flat-fee director compensation arrangements. In 2018, 67% of TSX 60 issuers paid their directors a flat-fee retainer instead of attendance fees, while only 49% of SmallCap Index companies opted for retainers over attendance fees. Beyond preparing for meetings, directors must balance a heavy workload and volume of information, while staying up to date on company and industry trends. Widespread adoption of flat-fee director compensation reflects an alignment of remuneration with workload and is recognition of the comprehensive value that board members increasingly bring to the companies they serve.[143] Interestingly, despite the trend away from paying directors on a per-meeting basis, director meeting attendance rates have remained at between 97% and 98% since 2012.[144]

DIRECTOR COMPENSATION LEVELS

In 2018, the average retainer for directors increased across Composite Index and SmallCap Index companies, with TSX 60 issuers compensating their directors 12% more than the previous year and Composite and SmallCap companies paying, on average, 16% and 18% more year over year, respectively. These figures represent a strong rebound from 2017, in which, compared with 2016, TSX 60 company retainers declined by 9% and Composite and SmallCap issuer retainers declined by 4% and 3%, respectively. However, year-over-year increases in 2018 fell short of their robust 2016 levels, when, compared with 2015, retainers for TSX 60 directors increased by 22% and retainers for the Composite and SmallCap company directors increased by 21% and 23%, respectively.

DIRECTOR STOCK OWNERSHIP GUIDELINES

The percentage of Composite and SmallCap issuers with director stock ownership guidelines has remained fairly constant at 78%. On average, these companies require their directors to hold stock equalling 3.8 times their annual fees within 4.4 years of board appointment. Since 2016, 97% of TSX 60 issuers have had director stock ownership guidelines, although there has been a slight decrease in holding requirements over the last few years, with directors being required to hold an average of 4.3 times annual fees in 2018, as opposed to averages of 4.6 and 4.9 times annual fees in 2017 and 2016, respectively. The time frame within which this stock must be accumulated has also trended upward, sitting at an average of 5 years in 2018, as opposed to averages of 4.9 and 4.8 years in 2017 and 2016, respectively. These minor year-over-year shifts do not indicate a movement away from established stock ownership guidelines, especially given the emphasis on board and company alignment as demonstrated by the increasing popularity of flat-fee compensation structures for board members.

Spotlight: Pay Ratio Disclosure in the United States and the United Kingdom

As of 2018, publicly traded U.S. companies are required to disclose how the pay of their CEOs compares with the compensation of the median employee (pay ratio). In addition to disclosing pay ratios, companies are also permitted to offer additional disclosure to provide investors who are exercising their say-on-pay vote with a more complete understanding of the company's executive compensation practices. Among the pay ratios that have been disclosed to date, no clear trend has emerged, and there is still wide variance between the pay ratios disclosed by companies within the same sector. For example, within the technology sector, Alphabet Inc., the parent company of Google, disclosed a pay ratio of 0.000005:1 (CEO Larry Page takes home $1 a year of compensation), while First Data Corp. disclosed a pay ratio of 2,028:1. Even among companies with a more typical CEO compensation practice than Alphabet Inc., variance in pay ratios is expected. This is because the U.S. Securities and Exchange Commission (SEC) has provided companies with significant flexibility in determining the appropriate methodology to calculate the median employee's annual total compensation.

Although the SEC has clearly stated that the pay ratio is not designed to facilitate a comparison between companies, comparisons are nonetheless being made. Moreover, certain analysts have used the median employee pay of a company to calculate the so-called Marx ratio, which is the relationship between a company's profits and how much the company's median employee is compensated – a rough proxy for the return on labour. Ultimately, it is important to remember that median employee pay is affected by many factors, including business model, geographic location and international operations, so comparisons of different companies' pay ratios (or Marx ratios) may not be particularly meaningful.

Similar pay ratio disclosure requirements for U.K. companies were enacted in July 2018, scheduled to come into force on January 1, 2019. The U.K. pay ratio rules vary from their U.S. counterparts in that all U.K. companies with more than 250 U.K. employees, whether public or private, are obligated to disclose their pay ratios (based only on employees employed in the United Kingdom). Furthermore, the U.K. rules require three pay ratios to be calculated – the CEO's total compensation to the total pay (including benefits) of the 75th percentile employee, the median employee and the 25th percentile employee. U.K. companies must choose from three different formulas in making the calculation and must disclose their reasons for using the selected formula.

Similar factors to those listed above for U.S. companies should be considered when comparing pay ratios disclosed by various U.K. companies. However, since U.K. pay ratios are calculated only on employees employed in the United Kingdom, international operations are less likely to skew results.

CHAPTER 08

Governance in a Rapidly Changing Technology Landscape

Information technology is becoming ever more relevant and disruptive to – and for many companies, intimately integrated with – business strategies and operations. As a result, managing risks relating to existing and new technologies remains a top priority for boards. In both of our *Davies Governance Insights 2016*[145] and *Davies Governance Insights 2015*[146] reports, we discussed cybersecurity risks, emphasizing the need for boards to assess their organizations' preparedness, relative expertise and disclosure practices as part of their broader risk management oversight responsibilities. In 2017, the Canadian Securities Administrators (CSA) published a report on the cybersecurity and social media practices of certain market participants. Earlier this year, the CSA also issued supplemental guidance addressing the importance of cybersecurity policies and procedures. In light of these developments, we continue to recommend that board members work to bridge the so-called cyber confidence gap, keeping in mind key advancements in the Canadian data protection legislative regime. In this section we also explore some of the developments in blockchain technologies that are pertinent to corporate governance.

Cybersecurity and Data Breaches

Rarely have regulations dominated headlines quite like the European Union's (EU's) *General Data Protection Regulation* (GDPR) this past spring.[147] Making fewer headlines but more pressing for Canadian businesses are the changes to Canada's privacy laws reflected in the *Breach of Security Safeguards Regulations* (Regulations)[148] and the related amendments to Canada's broadly drafted *Personal Information Protection and Electronic Documents Act* (PIPEDA) expected to come into force on November 1, 2018.[149] PIPEDA applies to every private sector organization in Canada that collects, uses or discloses personal information in the course of commercial activity. Boards and businesses should ensure they are informed about these requirements and know whether their organizations are prepared to handle cybersecurity and data breaches in a new regulatory era. And although there is as yet no government-mandated requirement to have a cybersecurity regime in place, certain regulated industries must consider additional guidelines regarding cybersecurity. These are discussed below.

Making fewer headlines but more pressing for Canadian businesses are the changes to Canada's privacy laws reflected in the *Breach of Security Safeguards Regulations* and the related amendments to Canada's broadly drafted PIPEDA expected to come into force on November 1, 2018.

Breach of Security Safeguards: Establish a Tracking, Notification and Reporting Regime

At a high level, the changes to PIPEDA and the new Regulations establish a mandatory notification and reporting scheme for data security breaches. Specifically, data security breaches must be internally tracked and if they result in the loss or unauthorized disclosure of personal information, may have to be disclosed to affected individuals and reported to the Privacy Commissioner of Canada.

There are three key takeaways from the impending legislative changes:

1. Cyber incident response plan. Businesses that do not already have cyber incident response plans should consider implementing them to ensure their organizations are able to meet the new requirements. PIPEDA will require tracking of all security breaches, no matter how small. Although there is no legal requirement to formalize the obligation to track security lapses involving personal information in an internal policy or plan, most organizations will see an operational and legal benefit from doing so

because formalization tends to improve compliance and, in the event of litigation or regulatory scrutiny, may act as a defence against recklessness and punitive damages.

An incident response plan should set out a comprehensive, step-by-step response to a data security breach, detailing roles, responsibilities and reaction time frames. For example, PIPEDA requires companies to assess the consequences of a breach and its potential for posing a "real risk" of "significant harm" in order to make a determination whether or not the breach is notifiable. Who in the organization will be responsible for making that assessment and how will they go about it? The steps required to come to a timely and robust conclusion should be carefully thought through in advance, because the assessment (and the procedures underlying it) may be scrutinized by the Privacy Commissioner or plaintiffs with the benefit of hindsight. The assessment itself is a complex undertaking, requiring a multi-dimensional analysis of affected stakeholders, data types, likely impacts, mitigation strategies and the future impact of non-disclosure. To ensure sound execution, key internal decision-makers should be clearly identified, third-party communications carefully vetted and appropriate technical, public relations and legal advisers engaged in advance. As with any crisis management protocol, the pressure to respond quickly to a breach is likely to be immense, making it imperative that an established process is in place.

An incident response plan should set out a comprehensive, step-by-step response to a data security breach, detailing roles, responsibilities and reaction time frames.

2. Breach logs, inspections and consequences. Businesses should expect serious repercussions from future breaches, including monetary penalties for contravention of the breach provisions of PIPEDA. In addition, issuers should be aware that non-compliance is treated as a criminal, not an administrative, offence. Commentary released by the Office of the Privacy Commissioner indicates that the Privacy Commissioner plans to scrutinize private sector cybersecurity practices more carefully in the future. Organizations will be required to maintain a record of security breaches and, as indicated above, there is no *de minimis* or materiality threshold regarding the obligation to internally record breaches. In other words, every breach must be tracked, whether or not it is notifiable. Commentators expect the Privacy Commissioner will also periodically inspect breach logs in order to catch industry laggards. The federal government's guidance on the Regulations indicates that the purpose of the breach record-keeping is to "facilitate oversight" and "encourage better data security practices." The U.S. experience with data breach notification also raises the spectre of increased and more frequent class action litigation once the new provisions come into force.

3. Third-party service providers. Most organizations' cybersecurity preparedness reviews need to include an examination of technology services provided by third parties. Given the prevalence of third-party cloud storage, web hosting, online data processing and other technology outsourcing, it may come as a surprise that PIPEDA does not address security breaches by technology service providers. A key tenet of PIPEDA is the accountability principle: ultimate responsibility for personal information rests with the organization that controls it, not that organization's service providers. Businesses that engage third parties to store, manage or process their data will be held responsible for PIPEDA compliance and for breaches. To comply with the breach record-keeping requirements, contractual agreements with third-party service providers should be reviewed, and amended if needed, to ensure that service providers are not only contractually bound to use personal information solely to provide the contracted service, but also required to keep the data secure and to notify the organization in a timely manner of any data breaches. In addition, organizations may need to revisit their current insurance coverage to determine whether the addition of cyber liability insurance, an evolving and maturing industry in Canada, would be a prudent risk management strategy for them.

A key tenet of PIPEDA is the accountability principle: ultimate responsibility for personal information rests with the organization that controls it, not that organization's service providers. Businesses that engage third parties to store, manage or process their data will be held responsible for PIPEDA compliance and for breaches.

Additional Data Protection Guidance in Canada

Except for the security requirements of the federal and provincial privacy statutes, there is as yet no government-mandated requirement to have an adequate cybersecurity regime in place. Some regulated industries have regulatory guidelines regarding cybersecurity, including the following:

- **IIROC.** In December 2015, the Investment Industry Regulatory Organization of Canada published the *Cybersecurity Best Practices Guide* and the *Cyber Incident Management Planning Guide* to help investment dealers manage cybersecurity risks and respond to cyber incidents.[150] In March 2018, IIROC published a notice warning investment dealers of the increasing frequency and sophistication of cybersecurity incidents and asking dealers to voluntarily report cybersecurity incidents to IIROC.[151]

- **MFDA.** In May 2016, the Mutual Fund Dealers Association of Canada published Compliance Bulletin No. 0690-C, *Cybersecurity*, to help its member dealers manage cybersecurity risks.

- **CSA.** In October 2017, the CSA published Staff Notice 33-321 – *Cyber Security and Social Media*, to report on a survey of cybersecurity and social media practices by firms registered to trade securities or to advise clients regarding securities. The staff notice provides guidance regarding cybersecurity and social media practices, and supplements the CSA's 2016 Staff Notice 11-332 – *Cyber Security*. The CSA notices emphasize the need for issuers, registrants and regulated entities to be aware of the challenges of cybercrime and take appropriate measures to safeguard themselves and their clients or stakeholders. The most recent notice reminds market participants that once they determine that cyber-risk is a material risk, they should provide detailed and entity-specific risk disclosure and avoid general, boilerplate disclosure. The CSA also advised that cyberattack remediation plans should address the way the issuer should assess the materiality of a cyberattack to determine the disclosure required under applicable securities laws. The plans should, in addition, cover when and how to make such disclosure. The notice reminds registrants to be vigilant in developing, implementing and updating their approach to cybersecurity "hygiene and management" and urges registrants to review and follow guidance issued by self-regulatory organizations. The CSA will consider cybersecurity issues in its reviews of issuer disclosure and in its oversight of registrants and regulated entities going forward.

- **OSFI.** The Office of the Superintendent of Financial Institutions regulates federally regulated financial institutions (FRFIs), including banks, most insurance companies and federal pension plans. OSFI does not currently have in place regulations requiring specific actions by FRFIs with respect to cybersecurity.

  However, Guideline B-10: *Outsourcing of Business Activities*, *Functions and Processes* sets out OSFI's expectations regarding technology-based outsourcing and states OSFI's expectations for cybersecurity risk management.[152]

In addition, businesses that are suppliers to, or partner with, entities in these regulated industries should expect a heightened focus on their cybersecurity practices as a pushdown effect of the above guidance.

Beyond Bitcoin: Enterprise Applications for Blockchain

The recent (and continuing) rise and fall of cryptocurrency prices have captivated many observers. More broadly, the technology underlying cryptocurrencies – blockchain – could prove to be a state-of-the-art innovation that can eliminate inefficiencies in many processes for companies, their investors and other stakeholders. But many still question whether blockchain is ready for prime time. Risk-tolerant startups as well as businesses and stock exchanges in emerging markets have been quick to capitalize on the opportunities, but more established enterprises have yet to adapt their operations in response to blockchain. While advocates promise business transformation through blockchain use on par with the advent of the Internet, risk managers are wary of speculation, subterfuge, illegality and untested technology.

Blockchain technology allows users to reduce reliance on an intermediary – an established player that sits between two otherwise untrusting parties to absorb counterparty risk using a centralized approach and functions as a gatekeeper to intermediate identity, storage and trust among counterparties. Blockchain offers a fully decentralized, disintermediated solution. Three primary elements of the system – user access control, historical transaction storage and future

SEC INTERPRETIVE GUIDANCE TO PUBLIC COMPANIES ON CYBERSECURITY

As we have discussed in past *Davies Governance Insights* reports, cyberattacks on public companies can have devastating effects. Negative consequences such as reputational damage, lost revenues and remediation costs can be expected following a security breach, and so it is vital that public companies make the protection of sensitive information a priority and consider their disclosure obligations relating to a potential cyber incident. Although disclosure requirements under U.S. federal securities laws do not explicitly refer to cybersecurity, the U.S. Securities and Exchange Commission (SEC) has stated that companies may nonetheless be obligated to disclose such risks and incidents.

The SEC's first interpretive guidance on cybersecurity, issued in 2011, discussed how disclosure of cybersecurity risks and cyber incidents should be incorporated into the existing framework of disclosure.[153] The 2011 guidance included the following recommendations: (i) registrants should disclose the risk of cyber incidents if these issues are among the most significant factors that make an investment in the company speculative or risky; (ii) registrants may need to disclose known or threatened cyber incidents to place the discussion of cybersecurity risks in context; (iii) if one or more cyber incidents materially affect a registrant's products, services, relationships with customers or suppliers, or competitive conditions, the registrant should provide disclosure in the registrant's "description of business"; (iv) if a material pending legal proceeding to which a registrant or any of its subsidiaries is a party involves a cyber incident, the registrant may need to disclose information about this litigation in its "legal proceedings" disclosure; and (v) registrants should address cybersecurity risks and cyber incidents in their management's discussion and analysis if the costs or other consequences associated with one or more known incidents, or the risk of potential incidents, (a) represent a material event, trend or uncertainty that is reasonably likely to have a material effect on the results of operations, liquidity or financial condition or (b) would cause reported financial information not to be indicative of future operating results or financial condition.

In February 2018, in light of the increasing significance of cybersecurity incidents, the SEC supplemented its 2011 guidance and addressed the importance of cybersecurity policies and procedures and the application of insider trading prohibitions in the cybersecurity context.[154] The SEC emphasized that companies should avoid generic cybersecurity-related disclosure, and that it may be necessary for companies to relay information about past or ongoing cybersecurity events when discussing future risks. In the aftermath of the April 2018 settlement of Altaba (formerly known as Yahoo! Inc.) with the SEC for US$35 million, U.S. public companies should be acutely aware of the costly penalties for failing to disclose a material cyber incident such as a cybersecurity breach.

However, not all SEC commissioners fully endorsed the supplemented guidance. A day after the SEC released its guidance, SEC Commissioner Kara M. Stein released a public statement in which she expressed disappointment with the SEC's limited action on cybersecurity.[155] She stated that meaningful disclosure on cybersecurity has remained elusive despite the SEC staff's best efforts in 2011 and that the new guidance is unlikely to help companies provide investors with comprehensive, particularized and meaningful disclosure about cybersecurity risks and incidents. Commissioner Stein suggested that the SEC should have instead engaged investors, market participants and public companies through a comprehensive notice and comment rulemaking process.[156]

transaction consensus – operate according to a pre-published protocol without the need for a single, centralized gatekeeper. Some argue that blockchain offers real solutions for tracking ownership of financial assets, such as equity securities, in a manner that can resolve many issues attributed to the current, and often flawed, shareholding infrastructure through a centralized depository. Blockchain share ledgers could lower the costs of trading, provide greater transparency concerning ownership records and render corporate voting more accurate, transparent, reliable and verifiable. As a result, several stock exchanges are investigating the potential benefits of blockchain's technology for equity and other markets – for example, the Australian Stock Exchange recently announced plans to implement a blockchain-based post-trade system, replacing the current Clearing House Electronic Subregister System, from as early as Q4 2020.[157]

Increasingly, we see expanding opportunities for more established enterprise clients to take advantage of blockchain technology. Incumbents have the resources for rigorous testing and vetting of regulatory compliance as business process applications based on blockchain technology come online. These applications include not only shareholding ledgers of the type discussed above, but applications for bills of lading in international shipping and personal identity management to facilitate KYC (know your customer) compliance.

An opportunity also exists to bridge the gap between centralized, trust-dependent architecture and the purely public blockchains. Blockchain applications that are neither entirely centralized nor entirely decentralized offer novel options for stakeholder engagement, transparency, industry collaboration, generational marketing and cost-sharing while preserving the strengths of centralized systems, such as quality control, market positioning and redesign flexibility. Established players have invested substantially to develop effective systems and achieve customer adoption predicated on a centralized model. For them, "trust-less" decentralization may offer little business benefit where name-brand reliance has already been hard earned. Moreover, all organizations will need to be aware of the risks of unproven new applications and those inherent in the nature of blockchain technology, which can complicate error correction, version control management and corporate governance oversight because it is unalterable and without centralized control. Boards and their management should continue to monitor developments in this area to identify opportunities to improve efficiencies within their organizations.

For more information about how to bridge the cybersecurity gap, please see our *Davies Governance Insights 2016* and *Davies Governance Insights 2015* reports. Additional information about regulatory developments affecting emerging blockchain technologies can be found in our publications *Demystifying Crypto in Canada: Will 2018 Be the Year of Blockchain?*[158] and *CSA Offers Tips for Token Offerings: Direction or Deterrence?*[159]

> Blockchain may offer real solutions for tracking ownership of financial assets, such as equity securities, in a manner that can resolve many issues attributed to the current, and often flawed, shareholding infrastructure through a centralized depository.

Spotlight: Mandatory Breach Reporting Under PIPEDA: Is Your Company Ready?

On November 1, 2018, the new breach reporting obligations under PIPEDA[160] and the *Breach of Security Safeguards Regulations*[161] (Regulations) will come into effect. All organizations that collect, use or disclose personal information in the course of commercial activity should be familiar with the following key components of the new regime.

- **Three-part notice requirements.** Under the new rules, where a company has experienced a data breach that poses a "real risk of significant harm" to an individual, the organization must notify "as soon as feasible" (i) the federal Office of the Privacy Commissioner of Canada; (ii) the individuals affected, unless otherwise prohibited by law; and (iii) other organizations or government institutions, if such organizations or institutions may be able to reduce the risk of harm or mitigate that harm.

- **"Real risk of significant harm" threshold.** PIPEDA defines "significant harm" broadly to include bodily harm, humiliation, damage to reputation or relationships, loss of employment, business or professional opportunities, financial loss, identity theft, negative effects on credit record and damage to, or loss of, property. In assessing the "real risk" of harm, organizations must consider the sensitivity of the information, the probability of it being misused, and any other factor prescribed by regulation.

- **Record-keeping obligations.** The new provisions will require organizations to keep records of every breach of security safeguards for 24 months from the date the organization determines that the breach has occurred. This requirement applies irrespective of whether the breach is likely to create a significant risk of harm to affected individuals. The records must contain sufficient information to allow the Privacy Commissioner to verify whether the organization complied with the reporting and notification requirements.

- **Content of reports and notifications.** Both reports to the Commissioner and notifications to individuals must include the circumstances and timing of the breach, the type of information exposed, steps taken to reduce the risk of harm, and contact information. Reports to the Commissioner must also include a description of the cause of the breach (if known) and an estimate of the number of affected individuals.

- **Manner of notification to individuals.** Notification to individuals generally must be given directly, but may be given indirectly through "public communication" (e.g., by posting to a website) where direct notification would likely cause further harm to the individual or undue hardship for the organization.

- **Cost of non-compliance.** An organization that knowingly fails to comply with the breach reporting or record-keeping requirements will be guilty of an offence punishable by fines of up to $100,000.

The new provisions will require organizations to keep records of every breach of security safeguards for 24 months from the date the organization determines that the breach has occurred. This requirement applies irrespective of whether the breach is likely to create a significant risk of harm to affected individuals.

CHAPTER 09

Other Top Governance Trends and Issues Under Focus

In 2018, we witnessed a sustained focus on certain governance issues that gained prominence in prior years, as well as some important legal developments. In this final chapter, we highlight for boards, general counsel and senior management some of the other top trends and developments relating to (i) the long-awaited amendments to the CBCA expected to come into effect within the next two years; (ii) director-shareholder engagement practices; (iii) an update on the previously proposed OBCA amendments; and (iv) understanding and mitigating anti-corruption risks. These developments may have an impact on the existing governance policies and practices of Canadian issuers and provide guidance on steps that boards and management can take to manage and mitigate enterprise risks. Additional background about these topics is available in our prior years' reports, including *Davies Governance Insights 2017* and *Davies Governance Insights 2016*.[162]

1 CBCA Amendments Will Implement True Majority Voting

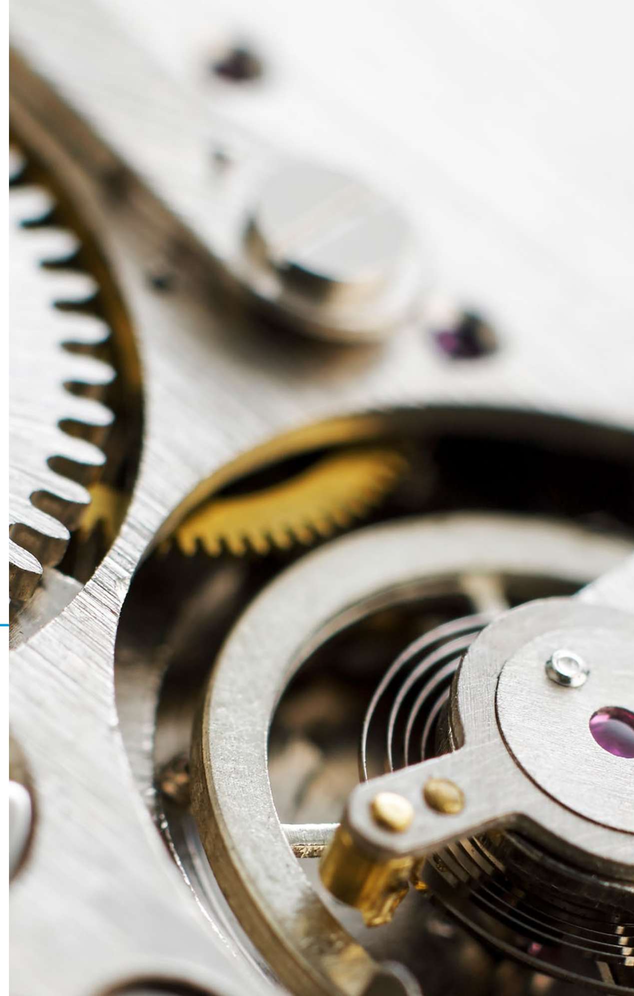
On May 1, 2018, royal assent was given to Bill C-25, An *Act to amend the Canada Business Corporations Act, the Canada Cooperatives Act, the Canada Not-for-profit Corporations Act and the Competition Act* (the Act).[163] Although many of the Act's provisions are now in force, some of its most significant amendments will take effect only once the relevant regulations have been adopted, at a later date. In particular, the provisions implementing a "true" majority voting standard for uncontested board elections will come into force only upon receiving an order of the Governor in Council, which is not expected before 2020.

When these provisions do take effect, they will significantly alter the way that shareholders participate in board elections at all federally incorporated public companies. Under the current plurality voting regime, shareholders are presented with only two options when casting their votes for a director nominee: "for" or "withhold." In an uncontested election, a director nominee can be elected to the board with only a single "for" vote regardless of the number of votes withheld. The amendments to the *Canada Business Corporations Act* (CBCA) will instead allow shareholders of federal public companies to vote "for" and "against" each director nominee, and require each director nominee to receive a majority (i.e., at least 50% plus 1) of "for" votes to be elected as a matter of law.[164]

The original incarnation of Bill C-25 would have required incumbent directors who failed to receive majority support to resign immediately, save for two limited exceptions that would allow the board to fill the vacancy with the undersupported director if necessary to maintain compliance with the board independence and Canadian residency requirements under the CBCA. After the proposed amendments' rigidness was criticized, however, the provisions were amended so that an undersupported director may continue in office until the earlier of (i) the 90th day after the day of the election and (ii) the day on which their successor is appointed or elected. This is a welcome change that will help avoid much-feared "sudden death" director elections that could instantly reshape a board or render it non-compliant with securities laws, stock exchange rules and, in some cases, contractual obligations.

For Canadian public companies already listed on the Toronto Stock Exchange (TSX), the upcoming changes implemented by the Act should have minimal impact in light of the existing majority voting standard that applies under TSX rules.[165] However, it should be noted that the amended CBCA requirements allowing an undersupported director to remain in office up to a maximum of 90 days after the shareholders' meeting are arguably more lenient than the existing TSX rules, which allow a director to remain on the board only in "exceptional circumstances," for which the TSX has

The provisions implementing a "true" majority voting standard for uncontested board elections will come into force upon receiving an order of the Governor in Council, which is not expected before 2020.



indicated a high bar exists. For issuers listed on the TSXV or other exchanges, however, the Act may represent a significant departure from the regimes under which they operate. This may put pressure on boards to pay closer attention to their governance practices relating to the identification, selection, nomination and election of directors.

Issuers currently have time on their side; however, we recommend that over the next year or two boards carefully consider their processes and practices relating to board and committee meeting attendance, director skill and assessment, overboarding, director-shareholder engagement and existing majority voting policies. This consideration is important for boards to ready themselves for compliance with the CBCA amendments, as well as to maximize shareholder support for incumbent nominees to avoid situations of directors failing to receive sufficient votes for re-election. We also recommend that boards carefully consider formalizing evergreen lists and director identification, selection and nomination policies to ensure they are able to act swiftly and consistently if one or more directors fail to receive majority shareholder approval for their election.

We also note that other CBCA amendments, such as those requiring enhanced diversity-related disclosure by federally incorporated public companies, have been adopted and will become effective once the relevant provisions are proclaimed in force (again, expected in the 2020 or 2021 proxy season). Details of these amendments are discussed in chapter 2, Looking Through the Gender Lens: Diversity and Harassment in the Era of #MeToo. The CBCA has also been amended to allow federal public companies that meet the requirements of, and are using, notice-and-access under National Instrument 51-102 and National Instrument 54-101 to make proxy-related materials and annual financial statements available under that notice-and-access regime, without investors' prior written consent or the need to seek exemptive relief under the CBCA. These latter provisions are now in force.

2 Shareholder Engagement in Demand

Many of the most important changes in Canadian corporate governance standards have come about as a result of investor pressure, as well as increased scrutiny of issuers' practices by shareholder advisory firms such as Institutional Shareholder Services, Inc. (ISS) and Glass Lewis & Co. (Glass Lewis), and corporate governance watchdogs such as the Canadian Coalition for Good Governance (CCGG) in Canada and the Council of Institutional Investors in the United States. For example, as a result of stringent pay-for-performance metrics established by ISS and Glass Lewis, many reporting issuers' executive compensation practices continue to face scrutiny and evolve as they strive to eliminate misalignments between executive remuneration and company performance that sometimes result in negative voting recommendations and voting outcomes on say-on-pay resolutions and director elections (for more details, see chapter 7, Executive and Director Compensation Trends and Issues: A Three-Year Review). In addition, public companies across a broader range of industries are facing shareholder proposals on policy and governance-related topics, including gender diversity, climate change and executive compensation; and some of these proposals are enjoying relatively higher levels of support.

Over the past few years, director-shareholder engagement has remained a key area of focus for Canadian public companies and institutional investors. Engagement can come in many forms and with varying degrees of aggressiveness. Establishing mechanisms to facilitate direct engagement between an issuer's significant investors and non-executive members of the board is now widely considered a key component of good corporate governance. A good engagement framework can help a company build relationships with shareholders, gain insight into their views and concerns on a multitude of environmental, social and governance issues, and serve as a powerful defence against activism and shareholder dissatisfaction. By engaging with shareholders, a board can proactively address shareholders' concerns that might otherwise manifest themselves as public shareholder proposals or proxy contests. As we discuss in greater detail in our *Davies Governance Insights 2017*, although boards need to navigate certain complexities when engaging directly with shareholders, the demand for engagement is not likely to dissipate. Therefore, recommended best practices that boards should keep in mind when developing an engagement framework include the following:

- **Have a formal policy or framework in place.** Formalizing a board's approach to shareholder engagement (including whether, when and how the board plans to engage) is critical. The engagement policy should be clearly communicated internally and to investors.

- **Aim for ongoing communication.** Delineate clear and simple communication channels for board-shareholder engagement and communicate these to the directors, management and investor relations teams. Proactively engage with shareholders to provide updates and to collect feedback. Consider taking advantage of technologies to facilitate engagement with shareholders and other stakeholders.

- **Monitor changes in investor ownership.** Understand your investor base, including your most significant shareholders, and be aware of the size and nature of their stake, as well as their investment strategies, rationales and track records.
- **Adopt different formats for communicating with different shareholders.** Engagement formats should vary with different shareholders and topics.
- **Focus on long-term strategy.** Although short-term plans and quarterly results are important, many institutional investors tend to focus on the longer term. When engaging, know your investors' time horizons and be sure to engage on both short- and long-term strategies, governance issues and concerns.
- **Have the right team and be prepared.** Consider which board members are best suited to engage with shareholders, depending on the shareholder and discussion topics. The chair may not always be the right person to facilitate engagement. Ensure your team is well apprised of the topics that are on and off the table, and any disclosure restrictions.
- **Annually review and revise your engagement practices.** As your business, investor-base, strategies and challenges evolve, so too should your engagement practices. Regularly evaluate the effectiveness of these practices, including having regard to your unique circumstances and practices implemented by your industry peers.

3 OBCA Amendments Put on Hold

As we discussed in last year's *Davies Governance Insights 2017,*[166] amendments to the *Business Corporations Act* (Ontario) (OBCA), Ontario's corporate statute, were proposed in 2017 under Bill 101, *Enhancing Shareholder Rights Act, 2017*, a private member's bill that proposed implementing, among other things, a majority voting standard for uncontested director elections in line with Bill C-25 (with some nuanced differences).[167] Although Bill 101 had passed second reading and was under consideration by a special committee, it died on the order paper when the Ontario Legislative Assembly was prorogued due to the provincial election in June 2018. Although it is possible for bills to be re-adopted in a new legislative session, doing so is a political decision that is difficult to predict.

As the OBCA stands currently, issuers incorporated under the OBCA that are not listed on the TSX will continue with a plurality voting system for director elections; TSX-listed issuers incorporated under Ontario law will of course remain subject to the TSX's majority voting requirements. This is likely not the last time that majority voting will be on policy-makers' agendas, however, and Ontario-incorporated issuers should be prepared for its re-emergence in the future. We recommend that boards of Ontario public companies evaluate and consider formalizing their policies and processes relating to director identification, selection and nomination, as discussed above in respect of the CBCA amendments.

4 Understanding and Mitigating Anti-Corruption Risks

Risk management in relation to anti-corruption practices remains a priority for boards and investors. *Davies Governance Insights 2016*[168] identified several key factors driving the importance of this area of risk management, including increasing globalization and greater activity in emerging markets. These trends continue to affect Canadian businesses in 2018, reinforcing the importance and complexity of anti-corrupt practices in risk management for which boards retain principal oversight responsibility. Understanding the scope of anti-corruption legislation and ensuring that robust policies and procedures are in place remain valuable means by which boards can fulfill their duties in this area and minimize their companies' exposure to the concomitant risks.

Canadian anti-corruption legislation addresses both Canadian entities operating abroad and foreign and domestic businesses operating in Canada. The main Canadian legislation governing foreign bribery is the *Corruption of Foreign Public Officials Act* (CFPOA).[169] In essence, the CFPOA prohibits anyone from giving or offering a loan, reward, advantage or benefit of any kind to a foreign public official to obtain a business advantage or as consideration for an act or omission by the official. The CFPOA prohibits both direct and indirect benefits, including non-monetary forms of benefits and potentially even benefits offered to or through third persons, as well as related deceptive book-keeping practices.

Exemptions are limited to cases in which the benefit is either (i) permitted or required under the laws of the relevant foreign state or (ii) a reimbursement of certain types of reasonable expenses that were incurred in good faith.

The Canadian *Criminal Code* makes it an offence to give a benefit of any kind to a federal or provincial government official in Canada as consideration for cooperation, assistance and exercise of influence or as consideration for an act or omission in connection with any government business.[170] In addition, the *Criminal Code* sets out separate offences for giving valuable consideration to any person to influence an election in order to obtain, retain or fulfill a government contract. It also sets out offences for providing certain types of benefits to judicial officers, members of Parliament, provincial legislators or municipal officials.[171]

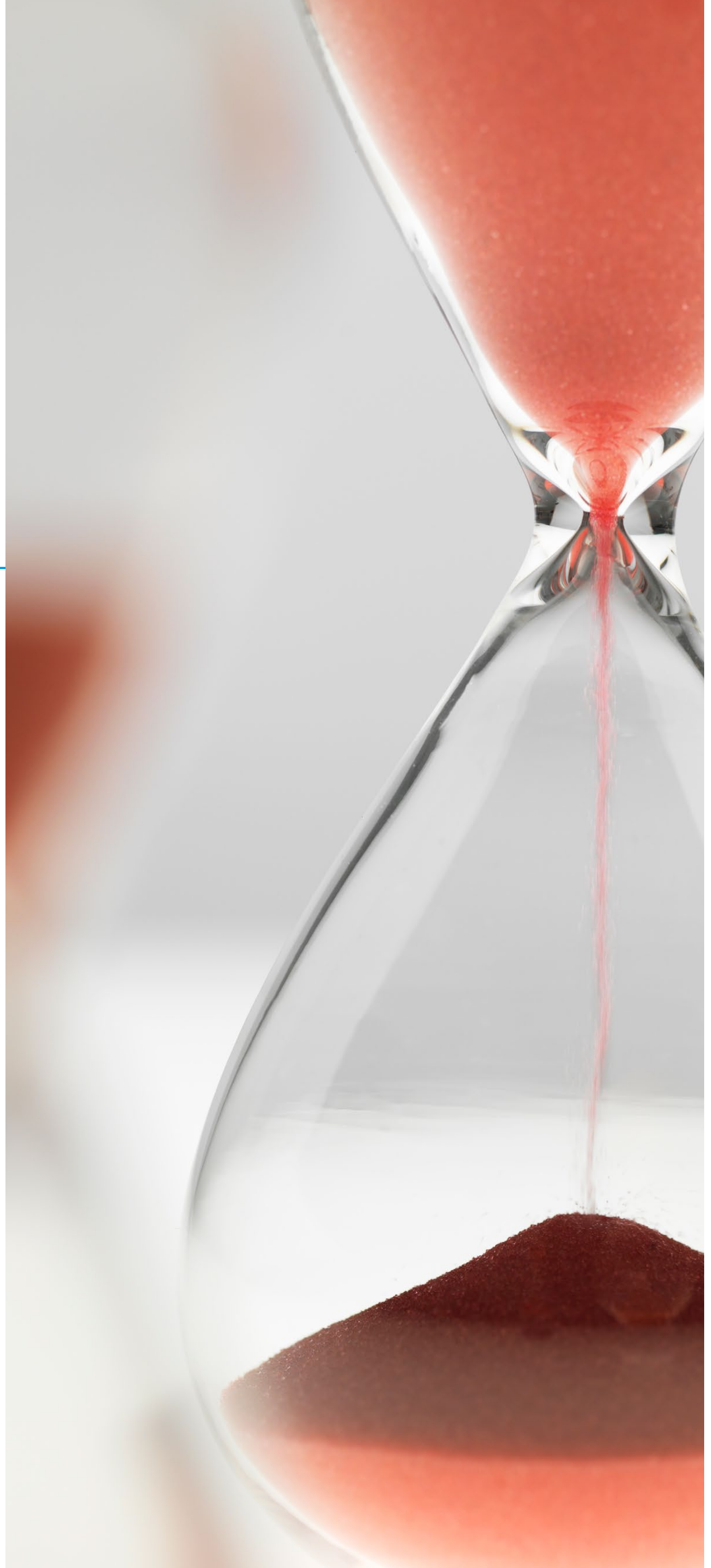
Violations of the CFPOA and the *Criminal Code* provisions are punishable by fines in the discretion of the court and/or imprisonment of up to 14 years.

In September 2018, amendments to the *Criminal Code* came into force establishing a regime for deferred prosecution agreements (DPAs).[172] DPAs allow for corporations accused of domestic bribery and certain other offences that would otherwise disqualify them from federal government contracts to be granted amnesty

In September 2018, amendments to the *Criminal Code* came into force establishing a regime for deferred prosecution agreements (DPAs).

from prosecution in exchange for the corporation's adherence to specified terms and conditions. The DPA regime provides the government with an alternative to the typical time-consuming and expensive process of pursuing a criminal conviction, and creates an incentive for corporations to self-disclose wrongdoing and make remediation in a more efficient manner.

Canadian businesses and foreign companies operating in Canada that deal with public officials should adopt and implement policies and training programs to ensure that their officers, employees and agents are aware of the CFPOA and *Criminal Code* provisions. In the event of a violation, management and boards should understand the new DPA regime in order to make reasoned decisions regarding self-disclosure. As the level of business activity involving emerging markets continues to increase, boards and management need to proactively manage corruption risk.



Database and Methodology

The quantitative analysis in this report is based on data provided by ISS Corporate Solutions, Inc., and drawn from the 2018 management information circulars of 388 issuers on the Toronto Stock Exchange (TSX), which are included in one (or both) of the S&P/TSX Composite Index and the S&P/TSX SmallCap Index as at May 31, 2018. There are a total of 1,505 issuers listed on the TSX. Although the 388 Composite Index and SmallCap Index issuers included in our study make up only 26% of all TSX-listed issuers, they represent 86% of the total market capitalization on the TSX.[173]

Descriptions of the relevant indices discussed in this report are set out below.

Composite Index: The S&P/TSX Composite Index (referred to as the Composite Index) comprises 248 issuers. It is the "headline index" and the principal broad market measure for the Canadian equity markets. It includes common stock and income trust units. Six of the 248 Composite Index issuers did not issue proxy circulars for the relevant period discussed; accordingly, our analysis is based on 242 Composite Index companies.

Two components of the Composite Index are referred to in this report:

- **TSX 60:** The S&P/TSX 60 Index (referred to as the TSX 60) is a subset of the Composite Index and represents Canada's 60 largest issuers by market capitalization.
- **Completion Index:** The S&P/TSX Completion Index (referred to as the Completion Index) is the Composite Index excluding the TSX 60 issuers. It comprises 188 issuers. (Our analysis includes only 182 of the issuers on the Completion Index because, as noted above, six issuers on the Completion Index did not issue proxy circulars during the period covered.)

SmallCap Index: The S&P/TSX SmallCap Index (referred to as the SmallCap Index) includes 205 issuers, 57 of which also meet the market capitalization eligibility criteria and are part of the Composite Index.[174] (Our analysis includes only 203 of the issuers on the SmallCap Index because two issuers did not have circulars.)

The number of issuers and specific constituents of the two indices covered in our study universe change periodically. This factor may in some cases affect comparisons of data points year over year.

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Researching and writing this report is an annual project undertaken by Davies Ward Phillips & Vineberg LLP and not on behalf of any client or other person. The information contained in this report should not be relied upon as legal advice.

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Notes

Chapter 01: Shareholder Proposals and Proxy Access

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