DAVIES

Governance Insights 2019

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9th edition

Davies Governance Insights 2019 is a comprehensive report on the trends and developments that shaped the corporate governance landscape in 2019. Based on extensive research data, the report provides an essential overview of the complex and diverse governance issues facing Canadian public companies today.

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.

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Executive Summary

Now into our ninth annual edition of *Davies Governance Insights*, it is clear that the scope of corporate governance has become more all-encompassing with each passing year. In the decade since the Supreme Court of Canada articulated a stakeholder-oriented approach to directors' and officers' duties in *BCE Inc. v 1976 Debentureholders* (*BCE*), public company boards have been under heightened pressure to consider the often-conflicting needs of shareholders and the broader stakeholder community. Boards of public companies in 2019 are required to focus not only on traditional metrics of financial performance but also on long-term sustainability through good governance, integrity, stewardship and meaningful engagement.

At the same time, changing social, economic and political norms; increasing concerns about such issues as climate change and diversity; and growing expectations of investors, employees, customers and communities are forcing many companies to rethink their larger purpose. In 2019, the question of the role of corporations – and who ought to be the ultimate beneficiary of their decisions – continued to intensify in both the political and business realms. In June 2019, the federal government expanded and codified the principles from *BCE* into the *Canada Business Corporations Act* (CBCA) by providing that, when satisfying their duty to act in the best interests of the corporation, directors may consider the interests of the relevant stakeholders, the environment and the long-term interests of the corporation. And in August 2019, the U.S. Business Roundtable departed from its long-standing endorsement of the shareholder primacy model, declaring that the purpose of a corporation is to create value for all stakeholders: customers, employees, suppliers and communities, as well as shareholders. Taken together, these and other developments discussed in this year's report highlight the difficult challenge facing today's directors to successfully balance the interests of many different constituencies and the competing frameworks in which they operate.

Additionally, as the role of corporations expands to factor into account the needs of a broader set of stakeholders, so too does the demand for greater transparency and convenience in disclosure and engagement. There is a growing recognition that boards need to be both responsive to key stakeholder interests and proactive in establishing clear communications on issues that are relevant to them. On all fronts – be it diversity, climate change or board composition – it is the responsibility of the board to ensure that a satisfactory dialogue with stakeholders takes place. Moreover, as some investors and other stakeholders focus increasingly on the broader purpose of a corporation, it is more critical than ever that companies clearly communicate how they are strategizing for sustainability over different time horizons and demonstrate their boards' active involvement in developing and overseeing the execution of that strategy.

Against this backdrop, this edition of *Davies Governance Insights* is intended to be a playbook to help boards, committees, in-house counsel and senior management successfully navigate the ever-expanding issues facing Canadian public companies. Key developments include:

– The federal government introduced several significant amendments to the CBCA in 2019, most notable among them the codification and expansion of the principles regarding directors' and officers' duties in *BCE* and new diversity-related disclosure requirements. We explore these and other governance-related amendments in **Chapter 1 – CBCA Reforms: Canadian Government Codifies Corporate Governance Practices.**

- Climate-related risks remained top of mind in 2019, as investors and other stakeholders continue to press companies for more robust and transparent sustainability disclosure. We outline the year's most significant developments, including the Canadian Securities Administrators' recent guidance on mandatory reporting of climate-related risks, in **Chapter 2 – Climate Change and Sustainability: New Standards for Sustainability Reporting and Disclosures.**

- Although 2019 witnessed fewer proxy contests in Canada compared with 2018, activity increased in some industries, notably in the resource sector. Two key developments included the increased involvement of institutional shareholders in contested situations and an uptick in activists' use of universal proxies. We review the changing activism landscape and offer practical tips for both issuers and activists in **Chapter 3 – Shareholder Activism: 2019 Trends and Major Developments.**

- Short selling has emerged in recent years as a new form of investor activism – and Canadian companies are increasingly finding themselves in the crosshairs. We discuss notable campaigns from the past few years, review Canada's legal and regulatory framework governing the practice, and explore how boards might respond to a short-selling campaign in **Chapter 4 – Short Selling in Canada: A New Avenue for Investor Activism.**

- Building a high-performing board of directors has never been more important and more complex. This year, we take an in-depth look at the many requirements and guidelines on board composition and offer best practices for boards to maximize their effectiveness, focusing on qualifications and skills, board commitment, tenure, board size, independence, diversity and board committees, in **Chapter 5 – In Focus: Building High-Performing Boards.**

- Although there was meaningful progress on a number of diversity-related metrics in 2019, Canadian public companies remain under pressure to improve their gender diversity practices. We outline the ever-expanding framework of gender diversity requirements and guidelines from corporate law, securities regulators, the Toronto Stock Exchange, proxy advisers and governance watchdogs, and provide practical tips for boards and senior management in **Chapter 6 – Navigating Gender Diversity in 2019.**

- A bill proposed in 2018 and statements from the Chairman of the U.S. Securities and Exchange Commission (SEC) indicate that the SEC will likely propose revisions to the U.S. shareholder proposal regime in the near future. We review the existing regime in the United States, consider the potential changes and take a look at the rising number of proposals in Canada in **Chapter 7 – Shareholder Proposals in the United States and Canada.**

- Market participants are increasingly calling on public companies to provide more transparent and convenient information. We discuss how corporations can transform their communication and engagement practices by leveraging company websites, making use of notice-and-access, hosting hybrid-virtual meetings and making appropriate use of social media outlets in **Chapter 8 – Innovative Tools for Convenient and Transparent Disclosure and Effective Engagement.**

- For some companies, long-term viability and profitability may depend on their ability to evolve into next generation governance organizations. In our view, such organizations have three critical elements: a focus on strategy, a people-centred approach and proactive engagement with key stakeholders. We explore how companies can successfully adapt to ever-changing business environments in **Chapter 9 – What's Next for Public Companies? Becoming a "Next Generation" Governance Organization.**

CHAPTER 01

CBCA Reforms: Canadian Government Codifies Corporate Governance Practices

In 2019, the Canadian federal government enacted several important reforms to the *Canada Business Corporations Act* (CBCA) that reflect its increased focus on corporate governance best practices. In this chapter, we explore key areas in which the amendments will affect Canadian public companies, including requiring public companies to hold annual non-binding "say-on-pay" votes, and prescribing new disclosure requirements regarding diversity, the well-being of companies' employees, retirees and pensioners, and the clawback of director and executive compensation. We also discuss the codification of key elements of the Supreme Court of Canada's seminal 2008 decision in *BCE Inc. v 1976 Debentureholders* regarding directors' and officers' duties to act in the best interests of the corporation. Finally, we review the CBCA's enhanced investigative powers and expanded enforcement provisions, which necessitate attention by private corporations to the statute's share register requirements.

Overview of Key CBCA Amendments

Amendments to the CBCA announced on March 19, 2019 in the federal budget (Bill C-97) signal that the current federal government envisions a more robust role for itself as a proponent of corporate governance best practices in Canada.

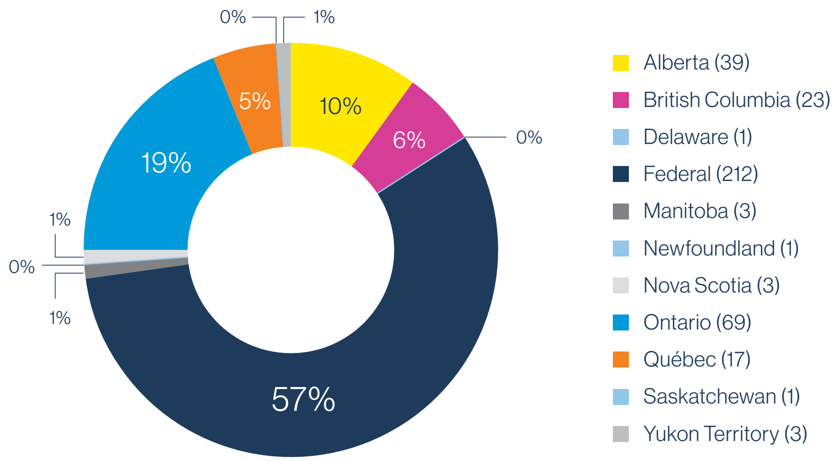
The CBCA corporate governance–related amendments include the following:

- codifying key elements of the 2008 decision of the Supreme Court of Canada (SCC) in *BCE Inc. v 1976 Debentureholders* (*BCE*)[1] regarding directors' and officers' duties to act in the best interests of the corporation;
- requiring that certain public CBCA corporations disclose to shareholders their approach to remuneration and hold annual non-binding shareholder say-on-pay votes;
- new disclosure requirements applicable to certain CBCA corporations regarding diversity, the well-being of companies' employees, retirees and pensioners, and the clawback of director and officer compensation; and
- enhanced investigative powers and enforcement provisions regarding the requirement that private CBCA corporations maintain a register of individuals with significant control.

The following sections examine each of these amendments in turn.

Amendments to the CBCA signal that the current federal government envisions a more robust role for itself as a proponent of corporate governance best practices in Canada.

FIGURE 1-1:
Jurisdiction of Corporations on the TSX Composite and SmallCap Indices (Number and Percentage) (2019)



Codification of *BCE* Fiduciary Duties

The CBCA amendments, which came into force on June 21, 2019, codify key elements of the SCC's 2008 groundbreaking decision in *BCE* regarding directors' and officers' duties to act in the best interests of the corporation.

The CBCA (like provincial corporate statutes) imposes a duty on directors and officers to act honestly and in good faith with a view to the best interests of the corporation. As we discussed in detail in last year's *Davies Governance Insights 2018*,[2] the SCC in *BCE* considered this "fiduciary duty" in the context of a leveraged buyout transaction where the interests of shareholders conflicted with those of certain bondholders of Bell Canada. The Court reaffirmed its decision in *Peoples Department Stores (Trustee of) v Wise* that "although directors *must* consider the best interests of the corporation, it may also be appropriate, although *not mandatory*, to consider the impact of corporate decisions on shareholders or particular groups of stakeholders," including "the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment."[3]

This principle has now been codified in the CBCA, by providing that in satisfying their duty to act in the best interests of the corporation, directors and officers may, but are not required to, consider the following:

– the interests of shareholders, employees, retirees and pensioners, creditors, consumers and governments;

– the environment; and

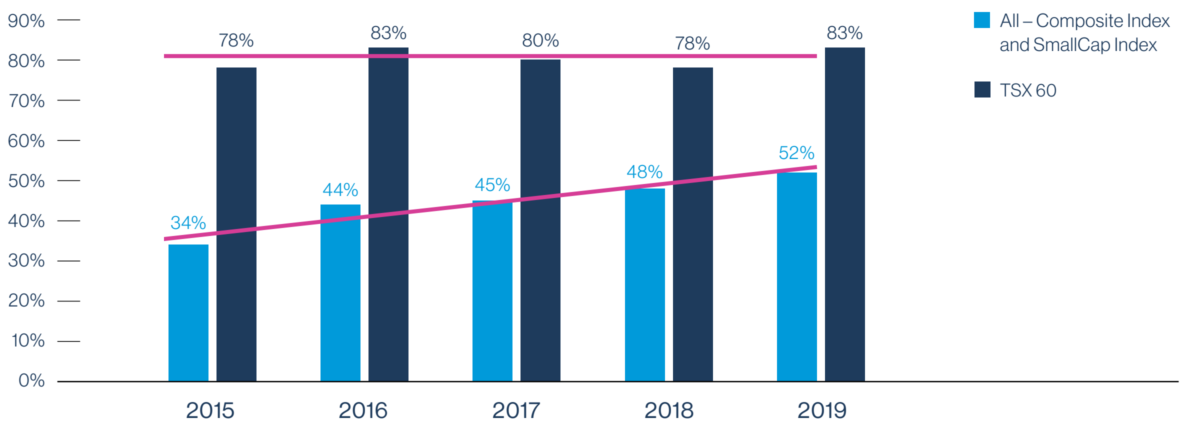
– the long-term interests of the corporation.

The CBCA amendments codify key elements of the SCC's 2008 groundbreaking decision in *BCE* regarding directors' and officers' duties to act in the best interests of the corporation.

Notably, retirees and pensioners were not specifically named stakeholders in the *BCE* decision; however, the explicit reference to retirees and pensioners is consistent with the federal government's policy focus on the protection of workers and pensioners.

It is unclear why these amendments were considered necessary or whether their implementation will result in any change in the behaviour of boards of CBCA corporations, since the principles stated in *BCE* are well known and frequently applied by Canadian courts. However, these changes may be consistent with developments witnessed elsewhere – namely, that many institutional investors and some issuers are increasingly focusing on a broader scope of stakeholders, interests and time horizons in determining the best interests of the corporation. Further details are contained in Chapter 9, What's Next for Public Companies? Becoming a "Next Generation" Governance Organization.

FIGURE 1-2:
Percentage of Companies that Adopted Say-on-Pay (2015–2019)



Mandatory Compensation Disclosure and Say-on-Pay Vote

While many Canadian public companies have voluntarily adopted annual advisory say-on-pay votes on executive compensation, there is no legal requirement in Canada for a corporation to conduct such a vote, unlike in the United States and the United Kingdom. In 2019, 83% of companies on the TSX 60, and 52% of all Composite Index and SmallCap Index issuers held say-on-pay votes. Additional details about say-on-pay and related executive and director compensation trends and developments in Canada and the United States can be found in *Davies Governance Insights 2018*.[4]

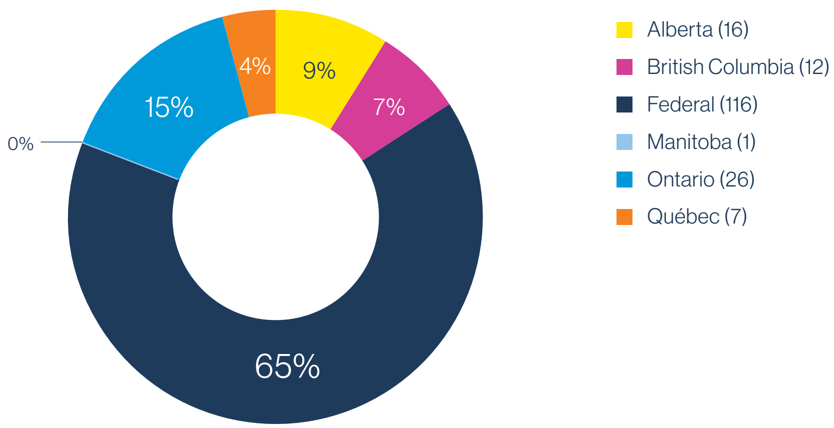
In 2019, 83% of companies on the TSX 60, and 52% of all Composite Index and SmallCap Index issuers held say-on-pay votes.

The CBCA amendments will now require "prescribed corporations" to develop and annually disclose to shareholders their approach to the remuneration of "members of senior management," to put this approach to annual non-binding shareholder say-on-pay votes; and to publicly disclose the results of the votes. The scope of prescribed corporations and the members of senior management to which these amendments will apply will be set out in regulations that have yet to be published.

Spotlight:
Recent Say-on-Pay Shareholder Proposals

Imperial Oil Ltd. (a CBCA corporation), Power Corporation of Canada (a CBCA corporation), Linamar Corporation (an Ontario corporation) and CGI Inc. (a Québec corporation) each faced a shareholder proposal asking the company to consider adopting a say-on-pay vote at its most recent 2019 annual shareholders' meeting. Unlike many other Canadian issuers that have voluntarily adopted the practice, the boards of directors of each of these four companies recommended that their shareholders vote against the proposals. They argued that the process of shareholder feedback on executive compensation could be better addressed through direct shareholder communications with the board and the corporation than through an allegedly blunt voting process, which was administratively burdensome and not issue-specific. Of note, the proposals were filed not only by various interest groups (SHARE and MÉDAC) that have been advocating for expanded say-on-pay votes in Canada and regularly submit proposals on different topics to public companies, but also by various Canadian institutional investors, including BC Investment Management Corporation, Seamark Asset Management Ltd., PSP Investments, the Alberta Investment Management Corporation and Caisse de dépôt et placement du Québec. When the regulations on say-on-pay are promulgated under the CBCA, regardless of the merits for not adopting say-on-pay, it is highly likely that Imperial Oil and Power Corporation, as CBCA companies, will need to adopt annual say-on-pay votes even though all proposals were defeated at their respective shareholders' meetings. Linamar and CGI, however, would not be required to adopt such votes, since they are, respectively, Ontario and Québec corporations.

FIGURE 1-3:
Composite Index and SmallCap Index Corporations by Jurisdiction that Did Not Adopt Say-on-Pay (Number and Percentage) (2019)



Although Bill C-97 received royal assent on June 21, 2019, at the time of writing this report the say-on-pay amendments have not yet been brought into force.

Although Bill C-97 received royal assent on June 21, 2019, at the time of writing this report the say-on-pay amendments have not yet been brought into force. The federal government has indicated it will undertake public consultations – in which public companies are expected to be able to participate – on the proposed amendments before adopting more detailed regulations. It remains to be seen whether the federal government will expand the requirements beyond current market practices.

New Disclosure Requirements on Diversity, Well-Being and Clawback of Incentives

The CBCA amendments will require prescribed corporations to disclose to shareholders information regarding the following:

- diversity among the directors and "members of senior management" (as defined by regulation);
- the well-being of employees, retirees and pensioners; and
- the clawback of incentive benefits and other benefits paid to directors and "members of senior management."

The federal government has since published amendments to the *Canada Business Corporations Regulations, 2001*, regarding the diversity disclosure requirements that will come into force when the diversity-related amendments to the CBCA are brought into force on January 1, 2020, in advance of the 2020 proxy season. Under the amended regulations,[5] the diversity disclosure requirements will apply to all public companies incorporated under the CBCA, including companies on the TSX Venture Exchange (TSXV), which have not to date been subject to the corresponding diversity-related disclosure requirements under Canadian securities laws. "Members of senior management" of corporations to which the above requirements will apply are defined as (i) the chair and vice-chair of the board; (ii) the president; (iii) the chief executive officer and chief financial officer; (iv) the vice-president in charge of a principal business unit, division or function, including sales, finance or production; and (v) an individual who performs a policy-making function. This definition is consistent with the definition of "executive officers" to which the corresponding diversity disclosure under National Instrument 58-101 – *Disclosure of Corporate Governance Practices* (NI 58-101) applies.

The amended regulations prescribe the following diversity disclosure by a public corporation:[6]

- whether or not the corporation has adopted term limits for its directors or other mechanisms of board renewal and a description of those term limits or mechanisms, or the reasons why it has not adopted them;
- whether or not the corporation has adopted a written policy relating to the identification and nomination of members of "designated groups" for directors and, if not, the reasons why;
- if the corporation has adopted the written policy referred to above, (i) a short summary of its objectives and key provisions; (ii) a description of the measures taken to ensure the policy is effectively implemented; (iii) a description of the annual and cumulative progress by the corporation in achieving the policy's objectives; and (iv) whether or not the board or its nominating committee measures the effectiveness of the policy and, if so, a description of how;
- whether or not the board or its nominating committee considers the level of the representation of designated groups on the board when identifying and nominating candidates for election or re-election to the board and how that level is considered, or the reasons why it is not considered;

The diversity disclosure requirements will apply to all public companies incorporated under the CBCA, including companies on the TSXV, which have not to date been subject to the corresponding diversity-related disclosure requirements under Canadian securities laws.

- whether or not the corporation considers the level of representation of designated groups when appointing members of senior management and how that level is considered or the reasons why it is not considered;
- whether or not the corporation has, for each group within the designated groups, adopted a target number or percentage (or range) for group members to hold positions on the board or as members of senior management by a specific date and:
  - for each group for which a target has been adopted, the target and the annual and cumulative progress in achieving that target; and
  - for each group for which a target has not been adopted, the reasons why; and
- for each group within the designated groups, the number and proportion, expressed as a percentage, of members of each group who hold positions on the board and are members of senior management, including all of its "major subsidiaries."

Although the required CBCA disclosure above is nearly identical to corresponding requirements under NI 58-101, it is important to note that it applies to all designated groups, which goes beyond gender. "Designated groups" means women, Aboriginal peoples, persons with disabilities and members of visible minorities. And as noted above, these disclosure requirements will apply to all CBCA public companies, with the result that TSXV-listed companies will need to provide this disclosure annually to their shareholders. Lastly, these requirements also apply to all "major subsidiaries" of CBCA public companies, which may require additional work for many issuers, particularly those with more complex organizational structures.

Although the required CBCA disclosure is nearly identical to corresponding requirements under NI 58-101, it applies to all designated groups, which go beyond gender. "Designated groups" means women, Aboriginal peoples, persons with disabilities and members of visible minorities.

The federal government's stated policy objective in introducing the diversity disclosure requirements is to promote diversity at both the board and senior management levels, because increased diversity is said to be not only a question of fairness but also a means to improved board quality, innovative thinking and corporate performance. Nonetheless, many have expressed concerns about the federal government wading into an area that is already covered under Canadian securities laws, while simultaneously expanding the scope of disclosure to more issuers and beyond gender. Among other articulated concerns, the CBCA amendments now create inconsistent disclosure requirements among TSXV issuers, since only those incorporated under the CBCA will be subject to any diversity-related disclosure requirements. In addition, inconsistent disclosure standards will now exist among TSX-listed issuers, since only CBCA-incorporated issuers will need to provide the expanded disclosure on designated groups, whereas under NI 58-101 others need only provide this disclosure with respect to women. Lastly, some have expressed concern that these requirements are, in fact, quite burdensome (and more so than the federal government articulated in its cost-benefit analysis conducted in connection with the CBCA amendments)[7] – for example, likely requiring issuers to set up self-identification and reporting systems to collect and compile the requested information in respect of different designated groups for the issuer and all major subsidiaries. It also remains to be seen whether these amendments will result in "forum shopping" by issuers, particularly junior issuers or new entrants to Canada's capital markets.

In addition to providing the above disclosure to shareholders annually, prescribed corporations must also file the information with Corporations Canada. We understand the federal government is working through the mechanics for facilitating these filings, including whether or not the filing of such information on SEDAR would satisfy the corporate filing.

With respect to the well-being and clawback disclosure, the federal government's policy focus appears to be on providing better oversight of corporate behaviour and the protection of employees, retirees and pensioners – a theme that was evident throughout the 2019 federal budget. These disclosure requirements will be brought into force by the federal government at a later date, not yet determined at the time of writing this report.

Share Register Requirements

The CBCA amendments also require that private CBCA corporations (including subsidiaries of publicly traded corporations) maintain a detailed share register of individuals with “significant control” over the corporation. The intent of these amendments is to provide greater transparency about the individuals who own and/or control corporations and to be consistent with international initiatives aimed at combating tax evasion, money laundering and terrorist financing. An individual with significant control is any individual who, *directly or indirectly*, holds registered or beneficial ownership of (i) shares that carry 25% or more of the voting rights attached to the corporation’s shares, or (ii) 25% or more of the corporation’s shares measured by fair market value.

> The share register must contain specified information about each individual with significant control, including name, birth date, address, jurisdiction of residence for tax purposes, the date on which the individual became or ceased to be an individual with significant control and a description of how each individual is an individual with significant control.

The share register must contain specified information about each individual with significant control, including name, birth date, address, jurisdiction of residence for tax purposes, the date on which the individual became or ceased to be an individual with significant control and a description of how each individual is an individual with significant control (i.e., a description of the individual’s interests and rights in respect of shares of the corporation). The share register must be updated within 15 days of the corporation becoming aware of any change to the information required to be included in the share register.

The register must be disclosed to the Director of Corporations Canada on request and must be made available for inspection by shareholders and creditors of the corporation. Additional CBCA amendments that came into force on June 21, 2019, create enforcement powers for the share register requirements. Corporations will be required to disclose their significant shareholder registers to investigative bodies (including police forces and the Canada Revenue Agency) when the investigative body has reasonable grounds to suspect that the share register would be relevant in investigating an offence committed by or involving the corporation or an individual with significant control. Any director or officer who knowingly authorizes, permits or acquiesces in the contravention of the new shareholder register requirements may be liable to a fine of up to $200,000, six months’ imprisonment, or both, whether or not the corporation is prosecuted for a related offence.

Some corporations, particularly those with complex ownership structures, may find it burdensome or difficult to comply with these share register requirements. In these cases, incorporation or continuance under a provincial statute that does not have such a requirement, such as the *Business Corporations Act* (Ontario), may be considered by some companies, depending on the circumstances. However, we expect that the provinces will follow suit in due course by amending their respective corporate statutes to provide for similar requirements.

Our Take:
CBCA Amendments May Prove Burdensome and Create Inconsistent Disclosure Regimes

By enshrining diversity disclosure, say-on-pay obligations and other corporate governance practices and principles into the corporate statute, the federal government is wading into areas that have largely been under the purview of provincial securities regulators or stock exchanges, or that have developed organically through the efforts of institutional investors and corporate governance influencers in Canada. Many may view the overlap and inconsistency between these new requirements and existing regulations and corporate governance practices as unnecessary, problematic and potentially quite burdensome. As many of the details have yet to be worked out, and most CBCA companies are only starting to implement the requirements, it remains to be seen to what extent these concerns will be justified. Importantly, with continued attention on corporations' appropriate purpose and the proper interests for directors and senior management to take into account in carrying out their duties, many will be anxious to see what, if any, impact the codification of modified *BCE* principles into the CBCA may have on the interpretation of directors' and officers' duties, and the application of the business judgment rule, in the future. In the meantime, directors and officers should remain attuned to the continued developments affecting their duties and reporting obligations, as well as evolving stakeholder expectations about how leaders carry out those responsibilities.

CHAPTER 02

Climate Change and Sustainability: New Standards for Sustainability Reporting and Disclosures

In *Davies Governance Insights 2018*,[8] we discussed the growing environmental, social and governance (ESG) movement and the trend toward increased reporting and disclosure of sustainability-related issues, including climate change and its related risk management by reporting issuers. In 2018 and 2019, investors and other stakeholders continued to press companies for greater transparency and accountability in managing their ESG risks and opportunities. In this chapter, we discuss the growing investor and regulatory expectations for more robust and transparent sustainability disclosure, as well as some of the most significant climate-related developments over the past year. We also review the disclosure standards applicable to climate-related issues, including the Canadian Securities Administrators' most recent guidance. In this context, we provide an overview of the leading climate disclosure frameworks and offer recommendations for boards and management of Canadian public companies to consider when tracking and reporting on sustainability initiatives.

Climate Change: Risks and Opportunities

Climate-related risks continued to grow in prominence over the past year. In October 2018, the United Nations Intergovernmental Panel on Climate Change (IPCC), a leading international authority on climate change, released a special report on the impacts of global warming of 1.5 degree Celsius above pre-industrial levels.[9] The IPCC was commissioned to explore the scientific feasibility of limiting the average global temperature increase to between 1.5 and 2 degrees Celsius in accordance with the 2015 Paris Agreement. The IPCC's report anticipates a progressive worsening of extreme weather events and other climate change impacts as global temperatures rise. The IPCC's findings are consistent with a new report released by Environment and Climate Change Canada detailing the current and projected impacts of climate change on Canada's environment.[10]

As the risks of climate change become better understood, governments and central banks are acknowledging it as a real source of financial risk. In May 2019, the Bank of Canada for the first time declared climate change a financial risk in its 2019 Financial System Review, bringing it in line with other central banks such as the Bank of England and the European Central Bank.[11] At the federal level, in June 2019, the Canadian government's expert panel on sustainable finance released its final report, which contains 15 recommendations to support the growth and development of sustainable finance in Canada.[12] It recommends the integration of climate risks into the supervision of federally regulated financial institutions. The report also includes recommendations designed to strengthen requirements for climate risk disclosure by Canadian public companies through a phased adoption of the disclosure framework of the Task Force on Climate-related Financial Disclosures (TCFD), discussed further below.[13]

Together with the federal government's recent implementation of its carbon pricing regime, discussed in our bulletin *Ontario Court of Appeal Rules That Federal Carbon Pricing Scheme Is Constitutional,*[14] governmental and financial sector responses to climate change have highlighted the pertinence of climate change risks – and related opportunities – for issuers. A recent analysis of the disclosures of over 6,900 international companies, including over 300 of the world's largest companies, published by the non-profit organization CDP (formerly the Carbon Disclosure Project) revealed that over half of these companies are identifying climate-related risks with the potential to have a substantive financial or strategic impact on their

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business.[15] Most companies report risks relating to potential policy and legal changes, and market shifts rather than physical risks.[16] The CDP found that approximately US$970 billion is associated with the risks reported by the world's largest companies, with approximately US$250 billion of this being linked to asset impairments or writeoffs.[17] At the same time, the opportunities associated with climate change are greater than the risks. Companies are identifying significant climate-related opportunities, including new products, resource efficiencies and alternative energy sources, representing potential financial impacts of over US$2.1 trillion. Companies are also reporting much lower costs to manage climate-related risks than their potential implications.[18] These findings suggest that companies that effectively identify climate-related risks and integrate these risks into their strategies early stand to capitalize on significant opportunities over the long term.

Growing Expectations for Sustainability Reporting and Responsible Investment

The year 2019 to date saw many issuers face continued pressure to increase transparency regarding their climate-related risks. As discussed further below, Climate Action 100+, a coalition of over 320 investors led by the California Public Employees' Retirement System (CalPERS), with more than US$33 trillion in assets under management, succeeded in pressuring major energy companies (including Royal Dutch Shell Plc and BP Plc) to improve their climate disclosures and align their strategies with the Paris Agreement.[19] In a similar initiative, as part of CDP's 2019 Non-Disclosure Campaign to drive further transparency regarding climate change, deforestation and water security, a group of 88 investors with almost US$10 trillion in assets is targeting over 700 global companies,

Companies that effectively identify climate-related risks and integrate these risks into their strategies early stand to capitalize on significant opportunities over the long term.

including 34 Canadian public companies, for not sufficiently reporting their environmental data, and is pushing them to disclose this information through the CDP's disclosure platform.[20]

ESG-focused investing has also continued to gain traction. In addition to recommending the creation of incentives for climate-smart investment in the retail investment space, the final report of the Canadian federal government's expert panel on sustainable finance calls for the promotion of sustainable investment as "business as usual" within Canada's asset management community.[21] Canadian investors and investment firms are already integrating these principles into their investment processes. A notable example is the recent launch by RBC iShares, Canada's largest exchange-traded fund provider, of six new exchange-traded funds on the Toronto Stock Exchange (TSX) that are designed to focus exposure on issuers with positive ESG characteristics.[22]

Investor interest has manifested in a growing number of shareholder proposals focusing on sustainability issues. Climate change has been a top issue in the past two U.S. proxy seasons, with investors pushing not only for better reporting on climate change but also for the inclusion of environmental factors as performance measures tied to executive compensation. Shareholder proposals on environmental and social issues continue to outnumber those filed on governance issues, indicating that climate change and sustainability remain a major concern for investors.[23] At the same time, a record number of environmental and social proposals are being withdrawn, likely as a result of successful engagement efforts.[24] In Canada, where environmental and social-oriented shareholder proposals have been less common, a management-backed proposal at TransCanada Corporation seeking reporting on climate change risk passed with overwhelming support. These trends suggest, consistent with our recommendations throughout this report, that a cohesive engagement strategy may go far in addressing investor concerns.

In response to growing investor demands for ESG disclosure, proxy advisory firms have continued to focus on ESG factors in the 2019 proxy season. In its *2019 Proxy Paper Guidelines* for Canada, Glass Lewis & Co. (Glass Lewis) announced that in the case of issuers that have not properly managed or mitigated environmental and social risks, it may recommend that shareholders vote against members of the boards who are responsible for oversight of these risks.[25] In addition, Glass Lewis announced that it will integrate sustainability disclosure guidance developed by the Sustainability Accounting Standards Board (SASB) into its proxy voting products.[26] While the extent to which these standards will affect Glass Lewis's voting recommendations and influence investors remains to be seen, issuers should be prepared to respond to these market demands for increased transparency on sustainability issues.

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ENERGY INDUSTRY UNDER PRESSURE

Over the past year, investors have continued to exert pressure on companies in the energy industry to improve their disclosures around climate change and adopt emissions targets. In late 2018, New York Stock Exchange (NYSE)-listed Royal Dutch Shell Plc announced that it would establish short-term carbon-emission targets after coming under pressure from institutional investors.[27] In an industry first, Shell pledged to link executive pay to the carbon-reduction targets. Shell has now signed a joint statement with Climate Action 100+ and has set a target for 2021 of 2% to 3% lower than its 2016 net carbon footprint.[28]

In early 2019, the board of directors of NYSE-listed BP Plc supported a proposal brought by Climate Action 100+ calling for disclosure on how the company's investments are compatible with the Paris Agreement and linking executive pay to reducing emissions.[29] The proposal, which was also backed by BP's management, obtained the support of almost all shareholders.[30] In a similar response to investor pressure, Glencore Plc, one of the largest global commodity producers listed on the London Stock Exchange, announced its plans to limit its annual coal production to align its business strategy with the goals of the Paris Agreement, after consultations with the Climate Action 100+ initiative.[31] Following in the steps of its industry peers in Europe, in April 2019 NYSE-listed Norwegian oil and gas company Equinor announced its intention to align its strategies with the goals of the Paris Agreement and link executive bonuses to climate targets.[32]

While European companies in the energy sector have demonstrated a willingness to respond to investor demands, investors have faced greater resistance in the United States. In April 2019, NYSE-listed Exxon Mobil Corporation, with the support of the U.S. Securities and Exchange Commission (SEC), blocked a shareholder proposal seeking to have the company adopt and disclose greenhouse gas (GHG) emissions targets in line with the Paris Agreement, despite support from major investors including the New York State Common Retirement Fund.[33] The SEC ruled that the non-binding proposal would "micromanage" Exxon by seeking to impose "specific methods for implementing complex policies" in place of managerial judgment.[34] Although the SEC did not support the attempt by NYSE-listed Chevron Corporation to block a similar proposal, a series of climate change–related proposals brought by shareholders of both Exxon and Chevron at their respective 2019 annual meetings failed to obtain shareholder approval. Nonetheless, the success of a similar climate change disclosure proposal at Exxon in 2018 demonstrates the potential for investor pressure to yield results in the U.S. energy sector, as discussed in *Davies Governance Insights 2018*.[35] See Chapter 7, Shareholder Proposals in the United States and Canada for further details concerning the U.S. and Canadian shareholder proposal regimes and recent developments.

Spotlight: Key Takeaways from the Second TCFD Status Report

In June 2019, the TCFD released its second status report (TCFD Report), which provides an overview of the climate-related financial disclosure practices of 1,100 companies in multiple sectors and regions over a three-year period.[36] In addition, the Task Force conducted a survey on companies' efforts to implement its recommendations for climate-related financial disclosures, as well as users' views on the usefulness of climate-related financial disclosures for decision-making. While some of the results of the disclosure review and survey are encouraging, the TCFD is concerned that not enough companies are disclosing "decision-useful" climate-related financial information. Below are some of the highlights from the TCFD Report.

1 **Disclosure of climate-related financial information has increased but remains insufficient.** Progress has been made to improve the availability and quality of climate-related financial information. The average number of recommended disclosures addressed by companies in their public reports has increased from 2.8 in 2016 to 3.6 in 2018, and the proportion of companies disclosing information that aligned with at least one of the TCFD's recommendations grew from 70% in 2016 to 78% in 2018. However, only about 25% of companies disclosed information aligned with more than five of the 11 recommended disclosures and only 4% of companies disclosed information aligned with at least 10 of the recommended disclosures.

2 **More clarity is needed on the potential financial impact of climate-related issues.** The top area that users of climate-related financial disclosures identified as needing improvement is for companies to provide more clarity on the potential financial impact of climate-related issues on their businesses. The TCFD Report indicates that without such clarity, users may not have the information they need to make informed financial decisions.

3 **The majority of companies do not disclose the resilience of their strategies.** As discussed further below, the TCFD advocates the use of scenario analysis to assess the resilience of an issuer's business strategy under different climate-related scenarios. Three out of five companies responding to the survey that viewed climate-related risk as material and used scenario analysis to assess the resilience of their strategies did not disclose information on that resilience. While the TCFD views this as an important gap in disclosure for companies with material climate-related risks, it is consistent with its understanding that companies are still in the early stages of adopting climate-related scenarios.

4 **Mainstreaming climate-related issues requires the involvement of multiple functions.** While sustainability and corporate responsibility functions are the primary drivers of TCFD implementation efforts, risk management, finance and executive management are increasingly involved as well. The TCFD advocates that the collaboration between multiple functions is critical to mainstreaming climate-related issues, with strong roles performed by the risk management and finance functions being especially important.

Climate-Related Disclosure and Sustainability Reporting: Trends and Disclosure Standards

As stakeholder expectations on climate disclosure have heightened, a number of organizations have advanced voluntary disclosure standards for climate risks. Current securities legislation in Canada already requires disclosure of certain material climate change–related risks in an issuer's regulatory filings, with further guidance provided in CSA Staff Notice 51-333 – *Environmental Reporting Guidance* and, most recently (as discussed below), CSA Staff Notice 51-358 – *Reporting of Climate Change-related Risks*. While securities laws do not prescribe a particular framework for disclosing those risks, many issuers are primarily doing so on a voluntary basis in accordance with one or more available disclosure standards. Canada's existing continuous disclosure regime requires issuers to disclose *all* material risks affecting their business and, where practicable, the financial impact of those risks, in their annual information forms (AIF) and management's discussion and analyses (MD&A) (and not solely in voluntary sustainability or corporate social responsibility (CSR) reports).

Additional prescribed climate disclosure may not be far away. For example, in its final report released in 2018, the federal government's expert panel on sustainable finance recommended modifications to the *Canada Business Corporations Act* to require all federally incorporated companies, not just public companies, to include climate-related disclosures in their annual reports. In addition, the International Institute for Sustainable Development has endorsed mandatory climate-related disclosure in Canada by 2021.[37] In the United States, institutional investors representing more than US$5 trillion in assets have also petitioned the SEC to require mandatory ESG disclosure by public companies.[38] In the near term, however, issuers still need to respond to stakeholder demands for greater transparency in climate disclosures by voluntarily disclosing key climate-related information.

And while the variety of available reporting standards has fuelled a trend toward greater climate-related reporting by many public issuers, it has also created confusion. In an effort to minimize the reporting burden on issuers, leading reporting frameworks and standards organizations, including the Global Reporting Initiative (GRI), TCFD, SASB, CDP and the International Integrated Reporting Council, recently announced the launch of a two-year project to align their guidance.[39] In the interim, issuers should focus on standards and disclosures that are appropriate to their industry, material to their stakeholders and relevant to their business plans and strategies. Issuers that are able to embrace available reporting standards to identify key climate-related risks and communicate these risks to investors are likely to adapt more easily to changes in guidance and growing investor demands for transparency.

CSA PROVIDES GUIDANCE ON MANDATORY REPORTING OF CLIMATE-RELATED RISKS

In August 2019, the Canadian Securities Administrators (CSA) published CSA Staff Notice 51-358 – *Reporting of Climate Change-related Risks* (CSA 2019 Notice), which provides guidance for reporting issuers to develop more effective disclosure of material risks, opportunities, financial impacts and governance processes relating

Current securities legislation in Canada already requires disclosure of certain material climate change–related risks in an issuer's regulatory filings.

to climate change. The CSA 2019 Notice does not create any new legal requirements; rather, it reinforces and expands upon guidance previously provided in the 2010 CSA Staff Notice 51-333 – *Environmental Reporting Guidance* (CSA 2010 Notice).

As discussed in *Davies Governance Insights 2018*,[40] the CSA's 2018 review of the mandatory and voluntary climate-related disclosure of 78 issuers on the Composite Index revealed that just under half of these issuers provided boilerplate disclosure or no disclosure at all.[41] The CSA also found a broad consensus among investors and other stakeholders that climate disclosure was largely deficient or incomplete. The ongoing release of generic, boilerplate disclosure by many reporting issuers led the CSA to issue the CSA 2019 Notice to elaborate on its previous guidance. The notice focuses primarily on issuers' disclosure obligations in their MD&A and AIF, and is intended to assist issuers in identifying material climate-related risks and improving their related disclosure. Below are some key takeaways from the CSA 2019 Notice:

1. Consider categories of climate-related risks and opportunities. The CSA 2019 Notice provides useful guidance concerning the categories of climate-related risks and potential opportunities that issuers should consider over the short, medium and long terms when disclosing climate-related information, as shown in Table 2-1. It also includes examples of risks that fit within these categories and the potential operational and financial impacts that could be relevant for disclosure, as well as questions for boards and management to consider in assessing the materiality of these risks. The CSA 2010 Notice also includes examples of entity-specific disclosure that issuers may find helpful.

TABLE 2-1:
Climate Change–Related Risks and Opportunities

Physical Risks	Transition Risks	Opportunities
– **Acute:** event-driven (e.g., increased severity of extreme weather events) – **Chronic:** longer-term shifts in climate patterns (e.g., sustained higher temperatures)	– **Reputational:** perceptions relating to how issuers contribute to or hinder a low-carbon economy – **Market:** shifts in supply and demand – **Regulatory:** increased regulation – **Policy:** actions that constrain or contribute to adaptation to climate change – **Legal:** legal actions and liabilities – **Technology:** new technology that displaces or disrupts old systems	– Resource efficiency and cost savings – Enhancement of existing processes or adoption of low-emission energy sources – Development of new products and services – Access to new markets – Building resilience along the supply chain

2. Conduct materiality assessments. The CSA 2019 Notice reminds issuers that for purposes of the MD&A and AIF, information is likely material if a reasonable investor's decision whether to buy, sell or hold securities would likely be influenced or changed if the information in question was omitted or misstated. Given that climate-related risks and their potential impacts are mainstream business issues, boards and management should take appropriate steps to understand, assess and disclose the materiality of climate-related risks to their businesses. For example, management should assess the current and future financial impacts of material climate-related risks on the issuers' assets, liabilities, revenues, expenses and cash flows over different time horizons. Issuers are also encouraged to draw upon voluntary disclosure frameworks to assist in making materiality assessments. Together, the CSA 2010 Notice and the CSA 2019 Notice set out a host of non-exhaustive guiding principles to assist issuers in making contextualized, entity-specific materiality assessments, having regard to a broad spectrum of climate-related risks over different time periods and taking into account both quantitative and qualitative factors.

3. Establish board and management expertise. Boards and management are advised to assess their relative expertise with respect to sector-specific climate-related risks to enable them to make informed decisions about risk management and disclosure.

4. Provide meaningful entity-specific disclosure. Boards and management should avoid vague or boilerplate disclosure. The CSA recommends that disclosure be relevant, clear, understandable and entity-specific to assist investors in understanding how issuers' businesses are specifically affected by all material risks resulting from climate change. Risk disclosure should also provide context for investors about how boards and management assess climate-related risks.

5. Create board oversight of climate-related issues. Boards should consider whether the methodology used by management to capture the nature of climate-related risks and assess their materiality is appropriate and effective. They should also consider whether oversight and management of climate-related risks and opportunities are integrated into issuers' strategic plans. Furthermore, boards should assess the effectiveness of issuers' climate-related disclosure controls and procedures to ensure the principal risks are being identified and appropriately managed.

6. Build climate-related risks into business processes and management practices. The CSA 2019 Notice encourages management to consider which business divisions or units are responsible for identifying, disclosing and managing material climate-related risks; their reporting lines to senior management; and the extent to which these responsibilities are integrated with mainstream business processes and decision-making. Management should also consider whether it has implemented effective systems, procedures and controls to gather reliable and timely climate-related information for purposes of materiality assessments, management decision-making and disclosure to investors, regulators and other stakeholders.

7. Prepare climate disclosure with the same rigour as regulatory filings. If issuers provide voluntary climate-related disclosure in accordance with one or more available voluntary disclosure standards, they may need to consider certain additional requirements and factors. The CSA 2019 Notice states that voluntary disclosure should be prepared with the same rigour as the issuer's regulatory filings and should not contain misrepresentations or obscure material information; all material information must be included in continuous disclosure (CD) documents (and not housed exclusively in voluntarily prepared sustainability, CSR and similar non-CD documents). If issuers disclose any forward-looking information relating to climate change, that disclosure must also comply with securities law requirements.

For further details about the CSA 2019 Notice and its impact on issuers, see our August 2019 bulletin, *Canadian Securities Regulators Provide Guidance on Climate Disclosure*.[42]

Detangling the Major Climate Disclosure Frameworks

The Global Reporting Initiative

The GRI is an international organization that has developed the GRI Sustainability Reporting Standards (GRI Standards), the first adopted global standards for sustainability reporting. As discussed in *Davies Governance Insights 2018*,[43] the GRI Standards are the most frequently used voluntary disclosure framework, particularly among major global companies. According to a recent Ceres analysis of the 476 largest companies of the Forbes Global 2000 (Ceres Report), 70% of major global companies use the GRI Standards in their disclosure, making the use of the GRI Standards the expectation rather than the exception.[44] The GRI Standards are designed to provide sustainability information to a wide range of stakeholders, including investors.[45] Accordingly, the GRI Standards are structured as an interrelated set of reporting standards on various economic, environmental and social topics, which are typically used to develop sustainability or CSR reports.

FIGURE 2-1: TCFD Recommendations and Disclosures

Governance:	Strategy:	Risk Management:	Metrics & Targets:
Disclose the organization's governance around climate-related risks and opportunities.	Disclose the actual and potential impacts of climate-related risks and opportunities on the organization's business strategy and financial planning where such information is material.	Disclose how the organization identifies, assesses and manages climate-related risks.	Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.

Source: Task Force on Climate-related Financial Disclosures[46]

Task Force on Climate-related Financial Disclosures

The TCFD was created by the Financial Stability Board in 2015 to develop recommendations for the disclosure of climate change–related risks and opportunities to investors, lenders and insurance underwriters. The TCFD's recommendations encourage disclosure of material information within four key categories: governance, strategy, risk management, and metrics and targets.[47] The TCFD framework also advocates the use of scenario analysis to assess the resilience of an issuer's business strategy under different climate-related scenarios. While the disclosures recommended in relation to strategy and metrics and targets require an assessment of materiality to be determined in a manner consistent with other risks in a company's regulatory filings, the TCFD recommends that information in respect of governance and risk management processes be disclosed irrespective of its materiality, as shown in Figure 2-1.

As of June 2019, nearly 800 companies and organizations with a combined capitalization of nearly US$9.3 trillion have expressed their support for the TCFD framework, an increase of more than 50% over the total identified in September 2018.[48] The percentage of public companies disclosing information aligned with at least one of the TCFD's recommendations has also grown steadily – from 70% in 2016 to 78% in 2018.

In line with the recommendations of the Canadian government's expert panel on sustainable finance in its final report, the federal government also announced in its 2019 budget its support for the TCFD disclosure standards and a phased approach to their adoption by major Canadian companies.[49] Although support for the TCFD framework is growing, disclosure continues to face challenges. According to the TCFD's second status report, companies are finding the disclosure of scenario analysis assumptions difficult.[50] The final report of the federal government's expert panel on sustainable finance encourages issuers to view scenario analysis as a tool to examine the exposure and vulnerability of long-term business strategy to various climate change pathways, rather than focusing on the specifics of the scenarios themselves.[51]

Sustainability Accounting Standards Board

The SASB is an independent, private sector organization focused on encouraging disclosure of sector-specific, material sustainability information that meets investor needs. In November 2018, the SASB released a complete set of final disclosure standards for 77 industries across 11 sectors, which identify a baseline set of financially material sustainability topics and their associated disclosure metrics for a typical company in each industry.[52] The SASB framework encourages the disclosure of only those climate change–related impacts that are reasonably likely to affect the financial

The SASB framework encourages the disclosure of only those climate change–related impacts that are reasonably likely to affect the financial performance or operating condition of a company and to affect shareholder value.

performance or operating condition of a company and to affect shareholder value. This standard is similar, although not identical, to the standard imposed on reporting issuers by Canadian securities laws.

According to *The State of Disclosure* report issued by SASB in 2017, which analyzed the financial filings of the top 10 U.S. companies in each of the industries, 73% of companies reported on at least three-quarters of the sustainability topics included in their industry standard, and 42% provided disclosure on every SASB topic.[53] With the recent announcement by Glass Lewis that it will integrate the SASB's standards into its proxy voting products, and the support of major asset managers such as BlackRock, Inc. for the framework, the SASB is likely to influence the discussion on climate change reporting in the near term.

CDP

CDP is a non-profit organization that has developed reporting questionnaires for the disclosure of information on climate change–related risks, water, forests and supply chains to investors and consumers. According to the Ceres Report, more than 86% of major global companies assessed disclosed using the CDP framework.[54] In 2018, the CDP updated its disclosure platform to align with the recommendations of the TCFD, meaning that in 2018, nearly 7,000 companies prepared TCFD-aligned disclosure through CDP.[55]

International Integrated Reporting Council

The IIRC is an international non-profit organization that has developed a principles-based framework for the reporting of concise, strategic and future-oriented information to a wide range of stakeholders (IIRC Framework).[56] The IIRC Framework encourages issuers to draw on information prepared in other reports, including financial statements and sustainability reports, to explain the full range of factors that materially affect the issuer's ability to create value over time. As a principles-based framework, the IIRC Framework does not prescribe specific key performance indicators but focuses on the disclosure of information relating to a company's governance structure, approach to risk management and other processes that may affect value creation. Approximately 1,600 companies in more than 65 countries are using the IIRC Framework to guide their reporting.[57]

Our Take:

Focus on Meaningful (and Material) Disclosure and Engagement

Regulators, investors and other organizations in Canada and globally are increasingly calling on issuers to build sustainability-related factors and considerations into their strategic plans and to provide financially relevant and reliable ESG disclosures. In light of these shifting market expectations, boards of directors and management should ensure they have robust programs in place to identify, understand and mitigate sustainability-related risks relevant to their companies' financial performance and strategies and should seek to strengthen the quality and clarity of their ESG disclosures, including focusing on providing more relevant and entity- and sector-specific disclosures. The following recommended practices can assist issuers in managing these expectations:

1 Focus on substance over volume

Issuers should focus on disclosure that is meaningful to stakeholders and relevant to long-term business plans. In accordance with best practices for disclosure, issuers should ensure that disclosure is accurate, consistent over time and reliable so as to be decision-useful to investors and other stakeholders. Issuers can draw upon available disclosure standards to select and report on the measures that are most material to their business. The array of available disclosure standards can assist issuers in tailoring their disclosures for specific audiences. In all cases, focus on what is material and ensure all material information is contained in issuers' AIF and MD&A, as required, and not solely in voluntary filings or communications.

2 Improve engagement

Issuers should view engagement as an opportunity to identify the sustainability issues that are most material to their investors and other key stakeholders. Transparency through engagement can also be an effective tool for managing stakeholder expectations for disclosure and demonstrating commitment to sustainability issues. Issuers that lag behind their peers in sustainability engagement are more likely to face scrutiny about their disclosure practices and compensation structures as demands for transparency increase.

3 Incorporate sustainability into governance practices

Issuers should ensure that their governance systems align with their sustainability goals. Investors and other stakeholders are paying attention not only to the effect of ESG-related risks on companies but also to the way companies and their boards are addressing these risks in their strategies and decision-making. Issuers should seek to strengthen their governance systems, including board oversight of ESG issues and risk management processes, and should disclose the impacts of these governance systems on the management of ESG-related risks.

4 Consider using sustainability metrics in incentive plans

Boards should consider whether to build key sustainability performance measures into executive compensation incentive plans, particularly where climate-related or other sustainability factors are material to the issuer's strategy, financial condition, enterprise risk management and/or long-term profitability. Incorporating sustainability metrics into incentive plans can help to concretize targets and align management with sustainable practices and produce better outcomes.

5 Implement effective oversight structures and processes

To maintain oversight of climate-related issues, boards should determine how to most effectively build climate change into board and committee structures. An effective oversight structure is critical to ensuring the proper assessment of climate-related risks and opportunities, appropriate strategic decision-making and the establishment and tracking of climate-related metrics and targets. Boards should ensure that oversight structures and mechanisms are established and functioning, and that those structures have a clear mandate and purpose. It is worth considering whether the risk committee should have primary oversight responsibility for climate-related risk and opportunity assessment, including scenario analyses.

CHAPTER 03

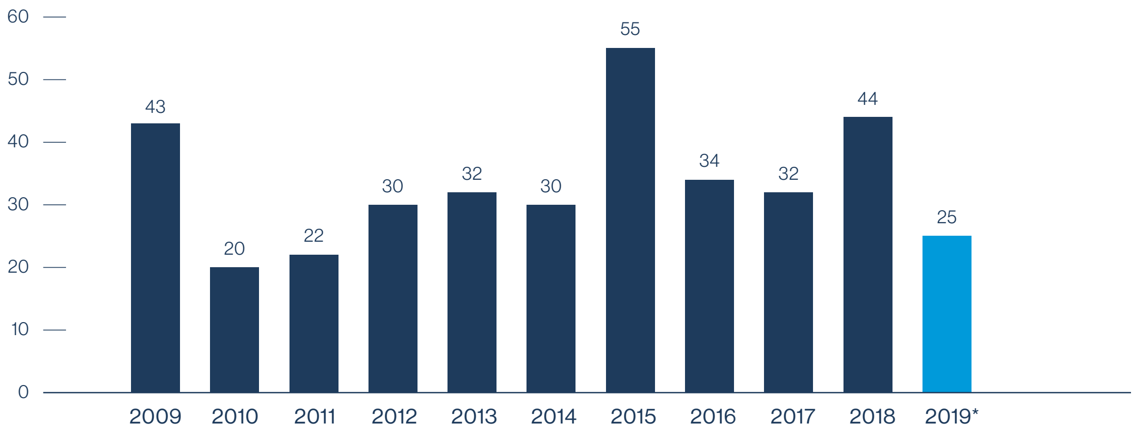
Shareholder Activism: 2019 Trends and Major Developments

While 2019 to date has witnessed fewer proxy contests in Canada compared with the corresponding period in 2018, activity increased in some industries, notably the resource sector, to levels not seen since 2015. We have also observed a number of important developments, including some that may be indicative of broader trends in proxy contest strategy. Two key developments in 2019 that we discuss in this chapter were the increased public involvement of institutional shareholders in contested situations and an uptick in activists' use of universal proxies. This year, market participants also received the long-awaited regulatory response to concerns about the use of soliciting dealer fees (or "vote buying") in proxy contests, which we review. We also discuss a recent decision of the B.C. Supreme Court, affirming that controversies relating to proxies should be resolved in favour of facilitating shareholders' right to vote. We round out our discussion with some practical guidance for both issuers and activists as they prepare for the 2020 proxy season.

Proxy Contest Activity in 2019: Key Highlights

Canadian proxy contest activity through the first eight months of 2019 trended lower than in the corresponding period in 2018 (25 compared with 29).[58] However, the overall activity level remains robust and is roughly consistent with proxy contest activity in the majority of the last 10 years, as shown in Figure 3-1.

FIGURE 3-1:
Proxy Contests in Canada (2009–2019 YTD*)



* As of August 20, 2019

Proxy contests in 2019 also followed a pattern similar to those in 2018 when categorized by the dissidents' principal objectives:

- In nine (approximately 36%) of the campaigns to date, activists sought to replace either a majority of the board of directors or the entire board.
- An additional six (approximately 24%) were "short-slate" campaigns targeting a minority of the board.
- The remaining 10 (approximately 40%) related to transactional or other non-board matters.

As we noted in *Davies Governance Insights 2018*,[59] the natural resource and energy sectors were hotbeds of activism in late 2018, with high-profile campaigns being launched against Detour Gold Corp. (by Paulson & Co. Inc.), Hudbay Minerals Inc. (by Waterton Global Resource Management Inc.) and Crescent Point Energy Corp. (by Cation Capital Inc.). This trend appears to be continuing in 2019, with 10 of the 25 contests to date being launched against companies in the natural resource and energy sectors, including a high-profile campaign involving TransAlta Corporation (by Mangrove Partners and Bluescape Energy).

Update on Soliciting Dealer Arrangements: IIROC Opposes "Vote Buying" in Proxy Contests

After years of calls for action by market participants and a public consultation process undertaken by the Canadian Securities Administrators (CSA), in May 2019 the Investment Industry Regulatory Organization of Canada (IIROC) released guidance to its dealer members (IIROC Notice) with respect to managing potential conflicts of interest in soliciting dealer arrangements.[60] While IIROC stopped short of an outright prohibition on the practice of "vote buying" in contested director elections, the admonition is sufficiently direct that we expect dealers will decline to participate in these one-sided fee engagements in the future.

Soliciting dealer arrangements generally refer to agreements entered into with one or more registered investment dealers whereby the dealer is paid a fee for each security successfully solicited to (i) vote in connection with a matter requiring securityholder approval, such as a plan of arrangement or a director election; or (ii) be tendered to a takeover bid.

Historically, the use of soliciting dealer arrangements has been fairly common and relatively uncontroversial in merger and acquisition transactions. In these circumstances, the soliciting dealer is typically paid a commission by the acquirer for each security that is tendered to the bid or voted in favour of the arrangement.

While IIROC stopped short of an outright prohibition on the practice of "vote buying" in contested director elections, the admonition is sufficiently direct that we expect dealers will decline to participate in these one-sided fee engagements in the future.

However, the use of soliciting dealer arrangements in a contested director election is significantly less common. When they are used in this context, the dealer is paid a commission, subject to a minimum and maximum amount, for each vote cast by the dealer's clients in favour of management's director nominees, conditional on the election of management's nominees. As we have previously discussed,[61] the use of soliciting dealer arrangements in contested director elections has been criticized by institutional shareholders, corporate governance watchdogs and the media. There have been only three publicly disclosed instances where soliciting dealer arrangements were entered into in connection with a Canadian proxy contest for the election of the directors of an issuer, all of which were implemented by the issuer:

- Octavian Advisors, LP's efforts to elect four of the eight directors of Enercare Inc. in 2012;
- JANA Partners LLC's efforts to elect five of the 12 directors of Agrium Inc. in 2013; and
- PointNorth Capital Inc.'s efforts to elect six of the eight directors of Liquor Stores N.A. Ltd. (now Alcanna Inc.) in 2017.

The IIROC Notice emphasizes IIROC Dealer Member Rule 42 and its related guidance, which requires that all existing or potential material conflicts of interest between a dealer and a client must be addressed "in a fair, equitable and transparent manner and considering the best interest of the client." Conflicts that cannot be addressed in such a manner must be avoided.

The IIROC Notice acknowledges that significant conflicts of interest are inherent in a soliciting dealer arrangement that results in fees paid only for votes in favour of one side, or only if a particular side is successful. The IIROC Notice states that such arrangements raise significant and unmanageable conflicts of interest for a dealer and that such conflicts should be avoided.

It is notable that Canada's securities regulators declined to take action of their own and prohibit the practice, viewing the matter as within the scope of IIROC's existing mandate on conflicts of interest. The CSA has, however, endorsed the IIROC Notice, signalling that the practice of vote buying is of concern to both IIROC and the Canadian securities regulators. Parties that propose to implement the practice in contested elections can likely expect recourse from IIROC and/or the CSA.

Universal Proxies on the Rise, but Still a Rarity in Canadian Proxy Contests

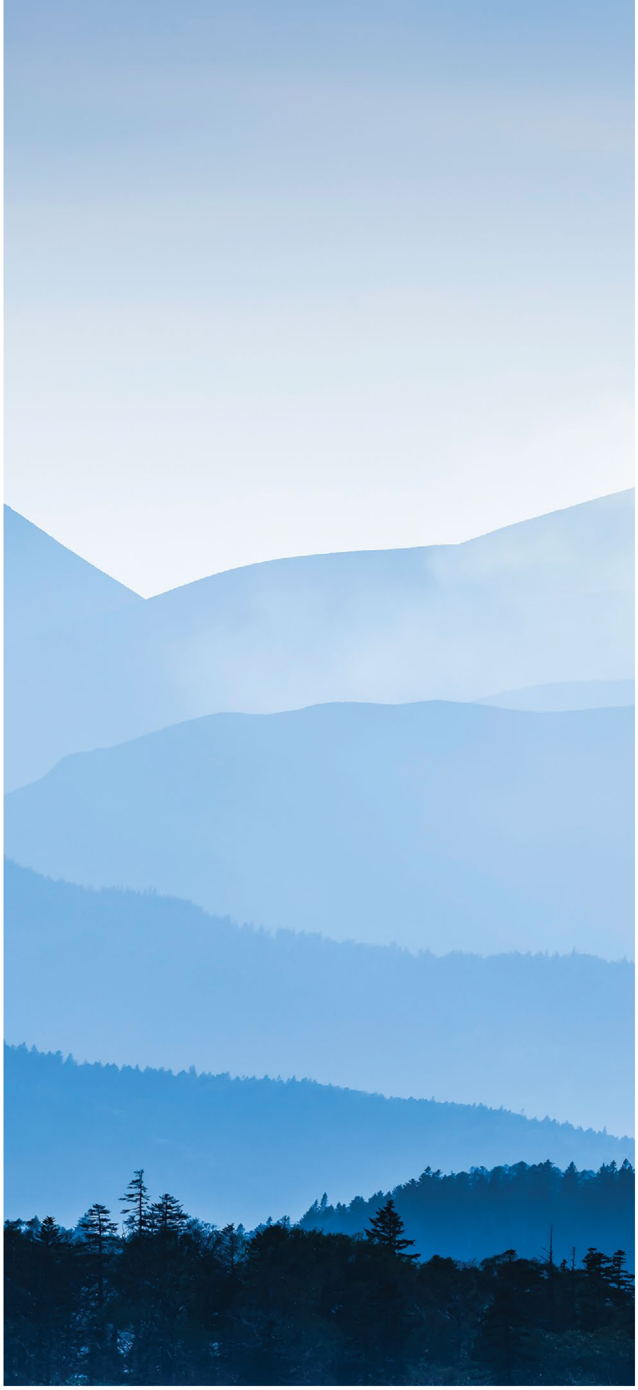
As discussed in our report *Shareholder Activism and Proxy Contests: Issues and Trends*,[62] Canadian proxy solicitation rules permit a company or a dissident shareholder to use a "universal" proxy card that lists the names of each management director nominee and each dissident director nominee. As a result, a shareholder may choose any combination of directors it determines would be best.

In contrast, the standard form of proxy, whether used by a dissident or the issuer, lists only that party's nominees. Shareholders can submit only one form of proxy, with any subsequent proxy revoking a previously submitted proxy, forcing a shareholder voting by proxy to choose one side's nominees over the other. In these circumstances, the shareholder would have to attend the meeting in person in order to vote for a mixed slate of nominees proposed by an issuer and a shareholder in a contested director election.

Canadian proxy solicitation rules permit a company or a dissident shareholder to use a "universal" proxy card that lists the names of each management director nominee and each dissident director nominee.

A universal proxy in a contested director election is generally viewed by governance experts as a shareholder-friendly tool that facilitates shareholder choice. However, there are a variety of strategic and other considerations that guide a party's choice on whether to adopt it. The first widely publicized use of a universal proxy in Canada was in the 2012 Canadian Pacific Railway (CP Rail) proxy contest, when a universal proxy was used by both the activist and the issuer. As shown in Table 3-1, our research reveals that the practice has been used (or at least publicized) by at least one of the parties in 14 contests in total since the CP Rail contest. Our research also shows that 2019 to date has yielded the highest number of contests (four) in which a universal proxy has been used. The data also reveal that a universal proxy has never been used by the issuer alone, and the issuer matched the shareholder's use of a universal proxy three times.

While a party can expect to receive governance accolades for using a universal proxy, the decision to do so requires an assessment of other considerations. On the one hand, if only one side uses the universal format, that side may increase the likelihood that shareholders will choose to use that side's card for voting purposes, thus providing earlier insight into voting trends. On the other hand, a party using a universal proxy also increases the chances that votes may be cast for the other side's nominees at the expense of some of its own. In addition, since a shareholder soliciting proxies will often issue its own dissident proxy circular after the issuer has issued its circular, an issuer wishing to use a universal proxy may be forced to reissue its proxy in the midst of the contest to include the dissident's nominees, a process that may prove confusing to shareholders. In CP Rail, the issuer was able to initiate the use of a universal proxy because the Pershing Square nominees had been publicly disclosed in advance of the issuance of the CP Rail circular.



While a party can expect to receive governance accolades for using a universal proxy, the decision to do so requires an assessment of other considerations.

TABLE 3-1:
Universal Proxies in Canadian Contests

Year	Issuer	Shareholder	Party Utilizing Universal Proxy	Outcome
2012	Canadian Pacific Railway Limited	Pershing Square Capital Management LP	Both parties	Shareholder win
2012	International Datacasting Corporation	Adam Adamou (former director of the issuer)	Shareholder	Shareholder loss
2013	MFC Industrial Ltd.	IAT Reinsurance Ltd.	Shareholder	Shareholder partial win
2013	Agrium Inc.	JANA Partners LLC	Shareholder[63]	Shareholder loss
2014	Americas Gold and Silver Corporation (formerly Scorpio Mining Corporation)	Tocqueville Asset Management	Shareholder	Shareholder win
2014	Sherritt International Corporation	Clarke Inc.	Both parties	Shareholder loss
2015	Dynacor Gold Mines Inc.	Red Oak Partners, LLC	Shareholder	Shareholder loss
2017	Granite Real Estate Investment Trust	FrontFour Capital Group LLC and the Sandpiper Group	Shareholders	Shareholder win
2017	Espial Group Inc.	Vantage Asset Management Inc.	Shareholder	Shareholder win
2018	Crescent Point Energy Corp.	Cation Capital Inc.	Shareholder	Shareholder loss
2018	DavidsTea Inc.	Rainy Day Investments Ltd. (controlled by Herschel Segal, the co-founder and former director of the issuer)	Shareholder	Shareholder win
2019	Hudbay Minerals Inc.	Waterton Global Resources Management Inc.	Shareholder	Shareholder win
2019	Methanex Corporation	M&G Investment Management Limited	Both parties	Shareholder partial win
2019	Knight Therapeutics Inc.	Medison Biotech (1995) Ltd.	Shareholder	Shareholder loss
2019	Aurinia Pharmaceuticals Inc.	ILJIN SNT Co., Ltd.	Shareholder	Shareholder loss

Note: Our research excludes proxies used in connection with a requisitioned special meeting to remove incumbent directors and elect new directors in their place.

The Canadian Coalition for Good Governance (CCGG) released its Universal Proxy Policy in September 2015.[64] The policy recommended an amendment to Canadian corporate and securities laws that would make the use of a universal proxy form mandatory in every contested director election at a Canadian public company. To date, no such legislation has been passed. It is possible that governance standards will evolve over time, making universal proxies the norm, as is the case with say-on-pay, but given market practice to date and legislative inertia on the subject since CCGG released its policy, proxy contest participants remain left to their own strategic considerations in deciding whether to deploy the practice for the foreseeable future.

Activism Goes Mainstream: Institutional Shareholders Find Their Voice

For the past several years, institutional shareholders have exerted significant influence in the evolution of Canadian corporate governance practices, with shareholder-friendly policies like say-on-pay and majority voting gaining widespread acceptance. The creation of CCGG in 2009 marked a significant advance in institutional shareholders openly advocating for improved governance practices. CCGG now comprises over 50 major institutional investors that collectively manage almost $4 trillion in assets.

While CCGG and institutional investors have been vocal in their demands for changes to Canadian governance standards, they have historically taken a decidedly quieter approach with respect to specific proxy contests, often making no public comment. In 2019, we may have seen the tide beginning to turn. Not only did the past year witness institutional investors more vocally engaging in active contests, but in one case, the institutional investor launched a successful proxy contest of its own.

Historically, any involvement by an institutional shareholder in a Canadian activist situation – whether in support of the issuer or the activist – has taken place out of the public eye. Pershing Square won a resounding victory in the now infamous CP Rail proxy contest in 2012, with widespread support among the shareholder base, which included a substantial number of institutional investors. This widespread support may not have been obvious, since, with the exception of two late-breaking endorsements, the support was not publicized. One press report on the eve of the shareholders' meeting indicated that, as it planned its approach to CP Rail, Pershing Square took comfort from the fact that many Canadian institutions were seeking a catalyst to deliver the message that they wanted change at CP Rail.[65]

It is possible that governance standards will evolve over time, making universal proxies the norm, but given market practice to date and legislative inertia on the subject since CCGG released its policy, proxy contest participants remain left to their own strategic considerations in deciding whether to deploy the practice for the foreseeable future.

Seven years after CP Rail, the Canadian market is more accustomed to activism, and, perhaps for that reason, 2019 has seen a number of examples of institutional shareholders publicly exerting their influence in contested situations, including those below.

Perhaps the most significant example of a potential sea change in institutional shareholder behaviour is the proxy contest launched in March 2019 by M&G Investments with respect to Methanex Corporation.

- TransAlta Corporation, a Calgary-based power generator and electricity marketer with shares listed on both the Toronto Stock Exchange (TSX) and the New York Stock Exchange (NYSE), was subject to an activist approach by Mangrove Partners in early 2019. TransAlta entered into a transaction with Brookfield Renewable Partners, one of its major shareholders, leading Mangrove to actively oppose the transaction and launch a public campaign, which included a withhold campaign with respect to certain directors of TransAlta. One of TransAlta's major institutional shareholders (and its single largest shareholder) – RBC Global Asset Management (RBC GAM) – publicly supported the Brookfield transaction and entered into a support agreement with TransAlta to vote for management's slate of directors at the upcoming shareholders' meeting. Ultimately, the shareholders voted overwhelmingly in favour of all of management's director nominees to the TransAlta board, including two Brookfield nominees who were nominated pursuant to the transaction. For more details, see our bulletin *The (Not So) Long Arm of the OSC: Commission Declines Jurisdiction in Public Interest Dispute*.[66] The public support of RBC GAM undoubtedly had some influence on the votes of other shareholders.

- Aimia Inc., the TSX-listed loyalty rewards firm best known for operating the Aeroplan program before selling it to Air Canada, has been subject to a continuing clash with its largest shareholder, Mittleman Investment Management, since 2018. Mittleman had threatened to launch a proxy contest in 2018, but the two parties entered into a settlement that included a two-year standstill. Aimia recently sued Mittleman, alleging, among other things, that it engineered a covert campaign to gain control of the company in breach of the standstill. Litigation against a significant shareholder carries significant risks for the issuer, including potential costs, management distraction and negative publicity. Even when the litigation may be justified, other shareholders may wish to stay above the fray rather than risk being drawn into the fight itself. In a rare step, a representative of RBC GAM, one of Aimia's major institutional shareholders, threw its public support behind Aimia in a statement to the *Financial Post*, calling the Aimia board of directors "seasoned" and "capable" and stating that "[t]his is a highly credible group of individuals with strong pedigrees who, once freed from the distractions of dissident shareholders with unclear agendas, can execute some basic steps to enhance value for shareholders in the near term."[67] While this public statement presumably will have no bearing on the outcome of the litigation, it may provide some cover to the Aimia board as it prosecutes its claim.

- Perhaps the most significant example of a potential sea change in institutional shareholder behaviour is the proxy contest launched in March 2019 by M&G Investments with respect to Methanex Corporation (TSX and Nasdaq), a Canadian company that supplies and markets methanol worldwide. M&G is a U.K.-based investment manager with approximately

US$338 billion of assets under management, and it had not commenced a proxy contest in its 85-year history. M&G was the largest shareholder of Methanex, holding approximately 16.5% of the shares, and was a long-term holder, having held the stock for over a decade.[68] M&G objected to Methanex's strategy to potentially undertake a significant capital expenditure without a partner. M&G pursued its contest in a measured and reasoned manner and arrived at a settlement with Methanex in less than three weeks. The settlement provided M&G with two board seats and a clear process to re-evaluate the potential capital expenditure project.

The notion that established institutional investors such as M&G and RBC GAM would take such an active and public stance in contested situations would have been unheard of a few years ago. It would seem no single factor is driving these and other institutions into a more activist stance. However, we expect the growth of index investing coupled with less liquidity in Canada compared with other markets restrain institutions from so easily doing the "Wall Street Walk" and selling their shares in the face of poor performance. In light of these and other factors, we expect this trend to continue, as institutional shareholders face increased pressure to take an active role with respect to their investments.

AIMIA LITIGATION SEEKS TO KEEP THE STANDSTILL RUNNING

When does a standstill expire? That is a key question at issue in a July 2019 lawsuit filed by TSX-listed Aimia Inc. against its largest shareholder, Mittleman Investment Management. As part of a settlement of a proxy contest in March 2018, Aimia and Mittleman entered into a standstill agreement whereby Aimia agreed to nominate two Mittleman nominees to the board and Mittleman agreed to vote in favour of the management nominees at the 2018 and 2019 shareholder meetings. The agreement also contained a broad standstill covenant that prohibited Mittleman from running a proxy contest. By its terms, the standstill ended on July 1, 2019.

In mid-July, 17 days after the Aimia board was elected at the 2019 shareholders' meeting, Aimia appointed two additional directors to its board, a move publicly criticized by Mittleman and other shareholders. Five days later, Aimia commenced legal proceedings against Mittleman, seeking, among other things, an order enjoining Mittleman from taking any steps to remove or replace directors elected at the 2019 shareholder meeting until the next annual meeting of shareholders. In support of its claim, Aimia alleged numerous breaches by Mittleman of the standstill agreement during its term. If successful, the Aimia lawsuit would effectively extend the expiry of the standstill covenant, at least as it relates to director elections, through the end of the 2020 proxy season.

Regardless of the outcome, the case raises an interesting interpretive issue when assessing the terms of a standstill. In that regard, the court will need to determine whether a covenant to vote in favour of the management slate should effectively insulate the board from the activist for the duration of its term in office, even if the express standstill provision has expired. We will be following this case closely and expect that, absent a settlement, the outcome of the case will depend to a significant degree on the court's findings of fact.

Synex Decision Affirms that Enfranchising Shareholders Is a Key Objective of Proxy Regulation

In the era of advance notice bylaws, the chance of a shareholder successfully carrying out an ambush at an annual meeting and electing directors from the floor has decreased to near zero. Perhaps for that reason, 2019 witnessed the first decision of a Canadian court in 30 years to consider and validate the strategy pursued by a shareholder at the annual meeting of Synex International Inc., at which the shareholder elected an entirely new board from the floor. Notably, the shareholder cast his votes in favour of his slate of director nominees using the discretionary authority given to him by shareholders who appointed him as their proxyholder on management's form of proxy. For more details, see our bulletin *Policy Prevails over Fine Print*.[69]

In *Russell v Synex International Inc.* (*Synex*),[70] the B.C. Supreme Court concluded that when a shareholder uses a management form of proxy to appoint someone other than the named management appointees and does not provide any voting instructions, the proxy provides full discretionary voting authority to the named proxyholder. Notably, the Court also determined the shareholder should not be bound by the typical "default" voting provisions in the fine print of the management proxy form, which provided that, in the absence of voting instructions, the proxy is to be voted in favour of management's recommendations. According to the Court, to impose those default instructions on a third-party proxyholder would be inconsistent with "business common sense." Accordingly, the shareholder in this case was able to elect an entirely new board by relying on the private proxy solicitation exemption and without issuing his own form of proxy.

Pointing to recognized industry practices and standards, including the *Securities Transfer Association of Canada Proxy Protocol* and the mechanisms in corporate and securities laws to enfranchise shareholders, the Court saw no reason to challenge the proposition articulated in the 1989 Ontario case *Canadian Express Ltd. v Blair* [71] that "disputed proxies must be construed in light of surrounding circumstances and where possible in a manner consistent with business common sense." Furthermore, the Court concluded that the entire regulatory scheme is geared to facilitating shareholders' right to vote.

In *Synex*, the Court noted that proxies are "fundamentally instruments of agency by which the proxyholder is appointed to represent the shareholder's interests." Accordingly, the proxyholder's specific authority at any particular meeting is only as broad as the language in the instrument conferring the authority. The Court examined in detail each of the three separate forms of proxy that had been used to appoint the shareholder as proxyholder and found that any apparent conflict in the default voting instructions in the form should be resolved in favour of enfranchising shareholders. In that regard, it would be inconsistent with business common sense for a shareholder to appoint a third party as its proxyholder only to restrict that third party to the default voting instructions crafted by management.

The Court determined the shareholder should not be bound by the typical "default" voting provisions in the fine print of the management proxy form, which provided that, in the absence of voting instructions, the proxy is to be voted in favour of management's recommendations.

Activism Preparedness: Some Practical Tips for Boards... and Activists

Accepted wisdom dictates that the best way for a public company to avoid a proxy contest is to ensure that it isn't an attractive target. Canadian public companies would be well-advised to devote time to preparing for activism, focusing on early detection, identifying and rectifying weaknesses in performance and clearly articulating their plans and strategies. We have set out below some practical actions that should be part of every issuer's preparations. We also provide some tips on how a company might best engage with an activist shareholder, should one emerge.

From the activist's perspective, there are many opportunities in the Canadian market to effect positive change, whether it be through campaigns to alter board composition or governance structures, or to pursue operational or transactional strategies. In doing so and planning its approach, an activist should carefully evaluate the potential legal pitfalls in executing its strategy – an early misstep can provide a target with an opening to slow the activist's momentum or, in some cases, stop the activist altogether. Below are some key Canadian legal considerations for the activist when planning a Canadian campaign.

In our view, proper preparation on both sides mitigates the chances of one side gaining a tactical advantage through legal manoeuvring or otherwise, which then allows both sides to make their best case to win the hearts and minds of shareholders.

Practical Guidance for Boards Before an Activist Emerges

1 Establish and maintain a response team

Create a standing internal response team composed of select members of senior management in key areas, including legal, finance, operations, strategy and investor relations. Designate a single spokesperson (often the CEO) and establish procedures to meet as necessary and engage with the board in the event an activist situation emerges. The internal team should be supported as appropriate by an external response team, often consisting of legal, financial and proxy advisers, as well as communications and public relations (and sometimes government relations) specialists.

2 Analyze your vulnerabilities and critically assess potential solutions

An activist's thesis almost always cites financial or other underperformance, whether on an absolute basis or relative to peers, and often links the underperformance to deficient governance structures and/or ineffective leadership. Evaluate the company through the eyes of an activist, looking for vulnerabilities, such as negative trends compared with your peer group and your environmental, social and governance profile (including board tenure), as well as existing or emerging value-creation opportunities. Identify possible solutions as well as the viability and associated risks of each. Doing so is valuable in itself and also facilitates a rapid response once an activist and its thesis emerge.

3 Ensure meaningful and constructive shareholder engagement

A robust shareholder engagement program, including engagement led by non-executive directors, should feature in most issuers' governance practices. The program should involve developing profiles of key institutional and other shareholders, including their voting policies and past voting 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 company's position. During this process, you may identify influential shareholders that would be willing, if needed, to take a public stand in favour of the issuer, and you may even learn that an activist is afoot, depending on the type of feedback received.

4 Develop and maintain an evergreen communications plan

Even in the best of times, releasing a public company communication can prove cumbersome, given the need for internal vetting procedures and protocols to ensure regulatory compliance. In an activist situation, this can often cause delays in responding to public statements by an activist, whose organization is often much smaller and nimbler and which is less constrained. To the extent practicable, an issuer can reduce delays in responding by having a ready-made and vetted communications plan that details the company's plans and strategies and includes potential responses to anticipated criticisms arising from its vulnerability analysis and shareholder engagement.

5 Monitor trading activity and changes in the shareholder base

Implement a stock watch program to monitor trading activity and regulatory filings (such as Canadian early warning reports and U.S. 13F, 13G and 13D filings). A robust program can reveal "under the radar" market accumulations, identify suspicious trading activity and facilitate a real-time understanding of the issuer's shareholder base, including changes in hedge fund and institutional shareholdings.

Practical Guidance for Boards When Engaging with an Activist

1 Ensure the board is engaged

The board should be involved in the response process once an activist emerges, particularly given that most activist situations stem from dissatisfaction with the management or direction of the company, matters that are ultimately the board's responsibility. The board may wish to consider establishing a special committee of the board, either out of convenience to ensure a nimbler response or to address any director conflicts. The board should establish a channel for regular contact with the response team to ensure a robust and timely response.

2 Diligence the activist

Once an activist emerges, you can be sure that the activist has conducted extensive diligence on the company. The issuer should do the same regarding the activist. Doing so often yields intelligence on matters such as the shareholder's likely tactics, its potential allies and the size of its stake. Seek to understand the shareholder's track record; identify key decision-makers and their credentials; identify known relationships with other significant shareholders, analysts, proxy advisers, asset managers and media; and evaluate the shareholder's exposure to the issuer, including, if possible, through derivative instruments.

3 Objectively review and assess the activist's proposals

Objectively, rather than emotionally, review and assess any proposal from an activist on its merits, separating the messenger from the message. Drawing on the information from your vulnerability analysis and shareholder engagement, consider possible responses and adjust your communication plan accordingly. The scope and extent of your response will be driven in part by whether the proposal has been made public; however, you should be prepared for the activist to eventually "go public," particulary if private discussions are not yielding results.

4 Assess the legality of the activist's conduct

The board should review the activist's actions in accumulating its position and securing any allies to identify any potential non-compliance with corporate and securities laws, such as early warning reporting requirements, restrictions on insider trading and tipping and rules governing joint actors (discussed below). While a complaint to a regulator or litigation might be considered, commencing any legal process should be carefully evaluated since it carries its own risks.

5 Develop a response plan specific to the activist and its proposals

In addition to updating communications, plans and strategies, the board and response team should consider whether and how to engage with the activist, recognizing that it is seldom in the company's interest to ignore or outright-reject an active shareholder. If a decision is made to engage, identify the representatives best suited to meet with the activist (guided in part by the activist's complaint). Determine the range of potential outcomes of engaging and assess whether settlement is a realistic possibility. If a settlement is not attainable, consider whether to adopt or execute a portion of the activist's proposal. If a decision is made to challenge the activist, develop a response plan aimed at garnering the most support from shareholders based on ongoing shareholder engagement. It is vital to maintain credibility throughout the process by avoiding personal attacks or emotional responses.

Practical Guidance for Activists Prior to Launching a Campaign

Given the tremendous amount of time and resources spent on identifying a target and developing a thesis, activist shareholders would be well-advised to develop their accumulation and approach plans with an understanding of potential legal pitfalls under Canadian corporate and securities laws. Even a seemingly minor "foot fault" can potentially lead to a loss of valuable time, a weakening of leverage or an outright loss. It is also true that while the relative lack of structural defences available to Canadian issuers can favour the activist, we have written elsewhere on certain factors that may surprise foreign activists when compared with the U.S. experience.[72]

1 Carefully consider disclosure triggers when building a toehold

Canadian reporting rules can seem fairly generous compared with those of other jurisdictions, given that, except where the target is subject to a formal takeover bid (in which case the trigger is 5%), a shareholder is not required to publicly disclose its stake until hitting a 10% ownership threshold. In addition, if the shareholder qualifies as an "eligible institutional investor," in many cases disclosure can be delayed until 10 days after the month in which the threshold is crossed (the Canadian equivalent of a 13G filing). However, absent those circumstances, an activist needs to be mindful that Canadian rules impose a "hard stop" at 10%, meaning that trading must cease until one business day has elapsed after the date on which the shareholder's early warning report has been filed. A similar moratorium of one business day applies when there is a material change in a previously filed report requiring disclosure.

2 Be aware of disclosure and other potential risks when seeking allies

Disclosure Triggers

If the activist is seeking allies among the shareholder base, Canadian joint actor rules could apply to aggregate the holdings of the activist with those allies, potentially triggering a disclosure obligation under early warning reporting rules sooner than anticipated or requiring an amendment to an existing filing. In one notable case, a court required an activist to update its early warning report in light of a joint actor finding and also delayed the shareholders' meeting by several weeks, buying valuable time for the target issuer.[73] The aggregation could also lead to more challenging issues if the combined ownership of the activist and joint actors approaches 20%, given that Canada has a bright-line takeover trigger at a combined holding of 20%.

"Tipping" and Insider Trading Prohibitions

In any discussions with potential allies, the activist must also consider Canada's insider trading rules, which are generally much stricter than those in the United States and prohibit trading while in possession of and, except in limited circumstances, sharing any material non-public information concerning a public company.

Proxy Solicitation Rules

Canadian rules broadly define a "solicitation" to effectively capture communications reasonably calculated to result in the giving, withholding or revocation of a proxy, with the general rule requiring a proxy circular to be sent to each shareholder whose proxy is solicited.[74] However, an activist can engage in significant solicitation activities in advance of sending a formal proxy circular with the proper use of exemptions, whether it be soliciting from 15 or fewer shareholders or engaging in a public broadcast solicitation through a press release or speech in a public forum. Notably, these exemptions are available only to the activist. However, each exemption has its own limitations and procedural hurdles, and a target issuer can be expected to carefully examine the activist's solicitation activities for any evidence of non-compliance.

3 Start building a director slate early

A large proportion of Canadian issuers have adopted advance notice bylaws, with varying degrees of information requirements associated with submitting a director nomination. While it is easier than in the past to find quality director candidates to stand on an activist slate, building an appropriate slate with due regard to matters such as industry experience, independence and diversity can be a time-consuming task. Importantly, that slate may need to be assembled quite early in (or before the launch of) the campaign, sometimes in advance of the activist requisitioning a special meeting of shareholders to propose nominees for election to the board.

CHAPTER 04

Short Selling in Canada: A New Avenue for Investor Activism

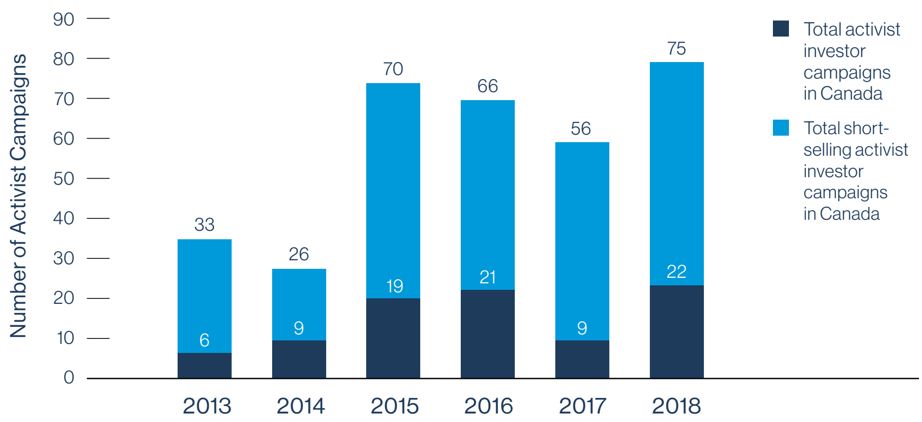
Over the past few years, short-seller activism has grown from a "low profile affair" to a major challenge for securities regulators and governing boards – and Canadian markets are no exception. In many cases, the consequences of a short-selling activism campaign for a company can be profound: a plunge in share price, the diversion of valuable time and resources, the need to rebuild the company's reputation and, in some instances, the initiation of a formal regulatory investigation based on the allegations made in the campaign. In this chapter, we examine the emergence of short-selling activism, review the legal and regulatory landscape governing its practice in Canada, compare some regulatory approaches in other jurisdictions and explore the potential responses available to boards of targeted companies. We also discuss some trends in short-selling activity in Canada, and spotlight three prominent examples over the past several years.

The Rise of Short Selling in Canada

Short selling has existed for (almost) as long as stocks have been freely traded. In the past several years, however, as can be seen in Figure 4-1, Canadian markets have witnessed a new trend: an overall rise in short-selling campaigns targeting public companies. Canadian companies in such diverse sectors as cannabis (Aphria Inc.), mining (Asanko Gold Inc.), retail (Dollarama Inc.), insurance (Manulife Financial Corporation) and aerospace (Maxar Technologies Inc.) have all found themselves the target of activist short sellers. The market capitalization of the targeted companies has ranged substantially, from approximately $171 million to $46.6 billion.

Canadian companies in such diverse sectors as cannabis, mining, retail, insurance and aerospace have all found themselves the target of activist short sellers.

FIGURE 4-1:
Short-Selling Campaigns in Canada (2013–2018)



Source: Activist Insight[75]

Spotlight: The Citron Research Fraud Allegations Against Shopify

Beginning in late 2017, Toronto Stock Exchange (TSX)- and New York Stock Exchange (NYSE)-listed Shopify Inc. was the target of a campaign launched by Citron Research, which claimed that Shopify should be investigated by the U.S. Federal Trade Commission for fraud and lack of disclosure. Citron Research alleged that Shopify's claim that it would make its customers millionaires through the use of its online platform was not true and that Shopify's predicted revenues would collapse. Citron Research subsequently asserted that the company's partnership with Facebook, which had generated important growth, was highly dependent on Facebook not changing its privacy policy.[76] In the aftermath of the two published Citron Research reports, Shopify's share price fell by approximately 11% and 12%, respectively. However, its share price rebounded by almost 48% in 2018 (an increase analysts largely attributed to its strong growth in sales), leaving the company almost unscarred by the short-selling campaigns. Nonetheless, Citron Research has continued to predict a downturn in Shopify's share price as recently as April 2019.[77]

What Is Short Selling?

Short selling is the practice of selling a security that an investor does not own. When shorting a security, the investor anticipates that it can buy back the security at a later date for a lower price in order to cover the initial sale. Rather than buying low and selling high, the investor is hoping to sell high and then buy low. These transactions typically take one of two forms:

- In a "covered" short sale, the short seller borrows the relevant securities (often from its broker) and then sells them on the open market. The short seller is hoping that the shares it just sold will decline in value, allowing it to purchase them on the open market at a lower price than the price of the initial sale. The short seller then returns the newly purchased securities to the lending party in order to cover its initial short position. While the short seller risks losing money on the trade if the security's price rises rather than falls, the underlying share lending arrangement ensures that the sales contract will be completed.

- In a "naked" short sale, the short seller sells securities without any firm commitment to borrow them and often without even ensuring they are available to be purchased or borrowed. Instead, the short seller hopes to purchase the securities on the open market to cover its position before delivery is due under the sales contract. There is therefore an additional risk that the investor will not be able to buy the securities necessary to cover the trade, potentially leading to a failure to deliver.

While some market participants and most issuers view shorting with considerable skepticism, short sellers can serve useful market purposes. For example, short sellers can uncover poor corporate governance practices, unsustainable business strategies or outright fraud, thereby increasing the efficiency of capital markets, correcting sometimes inappropriately inflated stock prices and fostering market liquidity. In this way, like other more traditional activist investors, short sellers provide an important check on issuers and their management. A short-seller activist, upon discovering reasons a company's shares may be overvalued, takes a short position in the company's securities and releases the information to the public, usually by publishing a negative report accompanied by a news release and social media posts, in the hopes that the market price will adjust accordingly. The activist benefits to the extent of the difference between the selling price of the shorted securities and the price of the securities it uses to close out its short position. On this basis, the market benefits from the increased transparency generated regarding the company's operations. In fact, a short seller has incentive to build a track record of success in having its allegations proven as that in turn lends credibility to its next campaign.

Although activist short sellers can serve a valuable function in increasing market transparency, modern technologies allow investors to easily publish anonymous, and potentially devastating, allegations to a large audience, leading to concerns by some that some short sellers may be engaging in abusive campaigns, pejoratively referred to as "short and distort" campaigns. The concern is that, rather than targeting genuine strategic or governance problems, some allegedly abusive short sellers deliberately circulate false or misleading information to drive down a stock's price in order to quickly profit from their short positions.

While some market participants and most issuers view shorting with considerable skepticism, short sellers can serve useful market purposes.

Spotlight:
Muddy Waters Continues to Target Canadian Companies

The most prominent case of short-selling activism in Canada remains a report released by San Francisco–based hedge fund Muddy Waters LLC targeting Sino-Forest in 2011. Muddy Waters released a report claiming, among other things, that Sino-Forest was a “multi-billion dollar Ponzi scheme […] accompanied by substantial theft.”[78] The Sino-Forest scandal dramatically shook Canadian capital markets and resulted in civil actions and criminal and securities law charges against Sino-Forest and its affiliates. In March 2018, an Ontario court awarded plaintiffs US$2.63 billion in a civil case against Sino-Forest’s co-founder and CEO Allen Chan.[79]

Since Sino-Forest, it appears investors and the market have placed significant stock in activists’ reports. The market response to short sellers’ allegations can be substantial and immediate. In 2017, Muddy Waters posted a tweet promising the release of a new short report on another Canadian public company, and speculation about the target’s identity led TSX-listed Element Fleet Management’s share price to fall sharply, ultimately losing 40% of its previous value. However, Muddy Waters was in fact targeting another Canadian issuer, Asanko. Element Fleet’s share price has largely recovered, while Asanko’s share price fell by half following the release of the report in 2017.[80]

While releasing unsubstantiated reports that have the effect of disrupting trading in a stock could constitute market manipulation (which is illegal under provincial securities laws), it is difficult to prove the intention to manipulate a stock, and it is difficult to prosecute short sellers on that basis when reports are based on opinion or even when they may contain misleading or misrepresented facts.[81] On August 15, 2018, for example, a panel of the Alberta Securities Commission (ASC) dismissed an interim cease trade application by ASC staff to temporarily block short seller Marc Cohodes from trading in TSX-listed Badger Daylighting Ltd. on the grounds that the ASC's enforcement staff failed to prove an urgent need for the interim order.[82]

While it can be difficult to objectively distinguish between legitimate and abusive short-selling campaigns, both can have costly effects on targets. For example, a 2018 study on the impact of public disclosure of short positions found that the disclosure was associated with changes in stakeholder behaviour and abnormal, negative returns for the target company, which persisted beyond the 100 days immediately following the announcement.[83]

Short selling is a legal investment strategy in Canada, which boasts relatively lenient regulations compared with other jurisdictions.

Short-Selling Regulation in Canada

Short selling is a legal investment strategy in Canada, which boasts relatively lenient regulations compared with other jurisdictions.[84] For example, naked short selling is generally permitted in Canada; to enter a short sale, subject to limited exceptions, the investor does not need to pre-borrow the securities necessary for settlement, provided that there is a "reasonable expectation" that the investor will cover its short position.[85] Moreover, unlike the United States, Canada has not reinstated a (modified) "uptick rule," which would effectively impose a stop on short selling when a share price continuously declines over a specified length of time. Finally, unlike conventional shareholders, short sellers in Canada are not required to publicly disclose their short positions under securities laws, regardless of how extensive they are relative to the company's outstanding shares. However, the Investment Industry Regulatory Organization of Canada (IIROC), which oversees all investment dealers and trading activity on debt and equity marketplaces in Canada does have mandatory short-sales reporting requirements for both exchanges and market participants and, as of January 2019, has been publishing bimonthly reports on the aggregate short positions in public companies. While these reports do not include the identities of individual short sellers, they do allow companies to monitor activity and changes in the short positions held with respect to their shares.

It will be interesting to see if the positive trend in short-selling activism will continue in Canada and how the legislatures, regulators and prosecutors will respond. On November 29, 2018, the *Financial Post* reported that the Canadian Securities Administrators (CSA), the body that represents Canada's 13 securities commissions or similar regulatory authorities, was in the preliminary stages of a project that involves reviewing "the nature and extent of abusive short-selling in Canadian capital markets."[86] While it is too soon to know what the CSA's recommendations might be as a result of the study, a review of regulatory approaches in other jurisdictions provides useful comparisons and may offer guidance on the future of Canadian regulation.

Short-Selling Regulation Across Jurisdictions

As highlighted in Table 4-1, short-selling regulations vary across jurisdictions. In the European Union (EU), for example, legislation introduced in 2012 banned naked short sales and introduced greater transparency to short positions. EU requirements now mandate that short sellers (i) report their short position to the relevant national authority when they reach or exceed 0.2% of the company's issued share capital and (ii) disclose their short position to the public when they reach or exceed 0.5% of the company's issued share capital, with ongoing disclosure obligations at 0.1% intervals. The net short position must be calculated for the corporate group as a whole to prevent circumventing the disclosure rules. To meet the EU requirements, the disclosure must include the size, relevant issuer and originating date of the short position.[87]

A BRIEF HISTORY OF THE UPTICK RULE OR TICK TEST

In 1938, the U.S. Securities and Exchange Commission introduced Rule 10a-1, otherwise known as the "uptick rule," which remained in force until 2007. The uptick rule applied to all NYSE stocks and required short sales to take place on an uptick (at a price higher than the last reported transaction price). The rule was later relaxed to also allow short sales on a zero-plus tick (at the same price as the last reported transaction price if the most recent price change was positive). At its simplest, the rule was designed to prevent successive short sales at progressively lower prices; instead, traders could short-sell shares only on a price uptick or zero-plus tick.[88] In 2007, U.S. regulators eliminated the uptick rule, and in 2012, Canadian regulators followed suit. Although a modified uptick rule (prohibiting short selling on securities whose price had fallen by more than 10% in a trading day) was reintroduced to U.S. markets in 2010, Canada has not reintroduced any uptick rule. Views on the efficacy of the uptick rule are mixed. Following the market crash in 2008, critics attributed increased market volatility to the repeal of the uptick rule. On the other hand, some empirical studies have indicated that "the rule hindered short selling's efficiency aspect, did not halt price declines, and could have an adverse effect on the execution quality of short sale orders." [89]

TABLE 4-1:
Short-Selling Regulation Across Select Jurisdictions

Country/ Supranational Organization	Federally Mandated Disclosure Requirement?	Are Covered Short Sales Permitted?	Are Naked Short Sales Permitted?	Is There an Uptick Rule (or Equivalent)?
Canada	No	Yes	Yes	No
European Union	Yes	Yes	No	No
United States	No	Yes	No	Yes
Australia	Yes	Yes	No	No
Singapore	Yes	Yes	Yes (if closed within 1 day)	No

In our view, any regulatory reform should be based on a quantitative analysis of the relative benefits and risks associated with short selling. Until a new regulatory framework is introduced, companies and their governing boards should tailor their responses to short-selling campaigns to the current regulatory framework.

Much like the EU, Singapore and Australia have short-selling disclosure requirements mandated by federal legislation.[90] Unlike the EU, however, both countries require that reports only provide the total short position in a security, not the identities of the individual short sellers. On the other hand, the United States does not have a centralized disclosure obligation with respect to short sales. However, self-regulating organizations, including stock exchanges, have begun collecting and publishing information on the volume of short sales relative to total trades.[91] Regardless of any formal disclosure obligations, short sellers may nonetheless voluntarily publicize their short positions in order to lend credibility to their thesis by showing they have "skin in the game."

In addition to the absence of federally mandated short-sale disclosure requirements, Canada is distinguishable for permitting naked short sales, which have been banned in the EU, the United States and Australia, and limited in Singapore. As noted above, naked short selling increases the risk that the trader will fail to deliver on the initial sales contract, potentially increasing market uncertainty.

Based on the comparative policies elsewhere, both disclosure requirements and the legality of naked short selling could be the subject of review and commentary by the CSA. In our view, however, any regulatory reform should be based on a quantitative analysis of the relative benefits and risks associated with short selling. Until a new regulatory framework is introduced, companies and their governing boards should tailor their responses to short-selling campaigns to the current regulatory framework.

Spotlight: The Spruce Point Campaign Against Dollarama

At the Robin Hood Investors Conference in October 2018, Ben Axler, founder and chief investment officer of the activist investment firm Spruce Point Capital Management, described Dollarama as a “strong sell” based on the company’s products and “troublesome management and governance red flags.”[92] The following day, Spruce Point published a report outlining concerns with the company’s shift to higher priced items, the saturation of the market and the “inexplicably high and likely unsustainable” margins. While the report contained a legal disclaimer that Spruce Point had taken a short position in Dollarama and “therefore [stood] to realize significant gains in the event that the price of its stock [declined],” Spruce Point did not publish the size of its short position nor the date when its short position ended. As a result, it is unclear whether Spruce Point realized a profit (and if so, to what extent) on the Dollarama campaign. Although Spruce Point’s report predicted Dollarama’s share price would fall as much as 40%,[93] the stock has been steadily increasing following an initial downturn in response to the report. Nonetheless, the fund is not finished with Canadian companies: Axler promised in March 2019 that “[Spruce Point is] going to do more Canadian activism, definitely.[94]

How Can Boards Respond?

Under the current Canadian regulatory regime, the board of a targeted issuer essentially has two avenues of response: (i) legal and (ii) commercial. Unfortunately, many barriers to an effective legal response exist, including difficulties in attributing sometimes anonymous reports to any source, the potential for formal investigations based on the allegations and responses, and the risk that prolonged and costly litigation may not address falling share prices in a sufficiently timely manner. Additionally, provisions restricting market manipulation in Canadian securities law do not provide a statutory civil remedy; a targeted issuer would typically need to rely on defamation laws or other common law torts to bring a claim directly against the short-seller activist, and such claims can be difficult to prove.

Strategic commercial responses may therefore be a preferable alternative, or useful companion, to a legal response. Where the issuer has maintained active shareholder engagement on, and transparency into, its business strategies and financial condition, the board will find itself better positioned to leverage its internal and external relationships, as compared with those who seek support for the first time in the face of activism of any sort. A board may turn to third parties for public support, including long-term investors willing to increase their stake or stock analysts offering an alternative to the short seller's assessment. While an immediate public statement without a full internal review could inadvertently worsen the situation by drawing greater attention to the short seller's campaign, reaching out to shareholders directly can allow a board to gauge the impact of the allegations. Additionally, as with responses to any form of activism (as discussed in Chapter 3, Shareholder Activism: 2019 Trends and Major Developments), a board should consider engaging a small internal response team to review the short seller's allegations and to develop a plan for the issuer's strategic response, pinpointing vulnerabilities in the issuer's conduct or the short seller's report. Finally, the board may take actions to demonstrate confidence in the company's future. For example, when faced with a short-selling campaign in 2015, TSX-listed Home Capital Group Inc. bought back shares and raised dividends, which not only demonstrated confidence in its business but also forced short sellers to pay additional fees to cover the dividend.[95]

Where the issuer has maintained active shareholder engagement on, and transparency into, its business strategies and financial condition, the board will find itself better positioned to leverage its internal and external relationships, as compared with those who seek support for the first time in the face of activism of any sort.

Our Take:
Short Selling Will Remain a Legitimate Form of Activism

After several years of significant short-seller activism in Canada, governing boards should expect the practice to continue in the years to come. While new CSA regulations may emerge and alter the landscape of short selling and the avenues of effective response, they are unlikely to curb the practice entirely. As a result, boards should consider developing a framework to anticipate and respond to activist investors generally, and short-seller activism in particular, not dissimilar from our guidance offered in Chapter 3, Shareholder Activism: 2019 Trends and Major Developments.

One of the greatest challenges many companies face in responding to short-seller activism is the lack of advance warning. Building and maintaining a high-performing board – with a robust oversight function and effective processes – can be an effective tool to guard against short-selling threats. A board that is committed to ongoing, meaningful shareholder engagement and debate over the strategy and performance of the company may be more likely to identify and address in advance any potential weaknesses that may be raised by activists (through a "vulnerability analysis"). Strong shareholder engagement, coupled with ongoing monitoring of IIROC short-sale reports for unusual trading activity, can also allow a board to identify perceived weaknesses before the company is subject to a short-selling campaign, thereby minimizing the risk of sudden drops in share price and allowing the board to develop effective strategies for the company as a whole.

CHAPTER 05

In Focus: Building High-Performing Boards

Building a high-performing board of directors has never been more important and more complex. The rise in shareholder activism, the increased scrutiny over environmental, social and governance issues and their oversight, and the growth of disruptive technologies are only a few of the reasons effective board governance is becoming an area of acute focus. Meanwhile, the corporate governance landscape has grown more complicated, making it increasingly difficult for directors to manage the sometimes inconsistent and evolving demands of multiple constituencies while also fulfilling their fiduciary duties. In this chapter, we take an in-focus look at a wide range of legal requirements, guidance and governance best practices aimed at helping issuers maximize the quality and effectiveness of their boards of directors.

Introduction

In an effort to help Canadian issuers build high-performing boards, this chapter synthesizes many of the requirements and guidelines for board composition from corporate law, the Canadian securities regulators and the Toronto Stock Exchange (TSX). We also discuss a number of relevant recommendations from Glass, Lewis & Co. (Glass Lewis), Institutional Shareholder Services, Inc. (ISS) and the Canadian Coalition for Good Governance (CCGG) relevant to directors' skills, qualifications and commitment. Throughout, we explore the best practices and current trends with respect to the composition of Canadian public company boards, focusing on director qualifications and skills, board commitment and overboarding, director tenure policies, board size, independence requirements, diversity and board committees.

Director Qualifications and Skills

LEGAL REQUIREMENTS

For companies incorporated under the *Canada Business Corporations Act* (CBCA) and the *Business Corporations Act* (Ontario) (OBCA), a director must be an individual who is at least 18 years of age, competent and not an undischarged bankrupt.[96] At least 25% of the directors of CBCA and OBCA companies must generally be Canadian residents and, unless the articles state otherwise, an individual need not hold shares in the company to be elected as a director. Director eligibility requirements vary by province and are set out in the corporate statutes of the province where the company exists.

BOARD COMPOSITION TOPICS

- Director Qualifications and Skills
- Board Commitment and Overboarding
- Director Tenure Policies
- Board Size
- Independence
- Diversity
- Committees

BEST PRACTICES AND TRENDS

Aside from the above requirements, there are few other prescriptive rules regarding director skills and qualifications. Having high-quality directors, as cited by CCGG, is of course a critical corporate governance requirement, with CCGG defining a director of quality as "someone with integrity, expert knowledge, business, industry or other relevant experience and with the time and motivation to understand and carry out his or her fiduciary duties in the long-term best interests of the company and all its stakeholders."[97]

Although having quality directors should be a top concern, the ideal composition of any board will ultimately depend on many company-specific variables, including the type and size of the company, the industry and a director's "fit" with the board. The following sections outline some recommended best practices for achieving a strong mix of director skills and experience.

SKILLS AND COMPETENCY MATRICES ON THE RISE

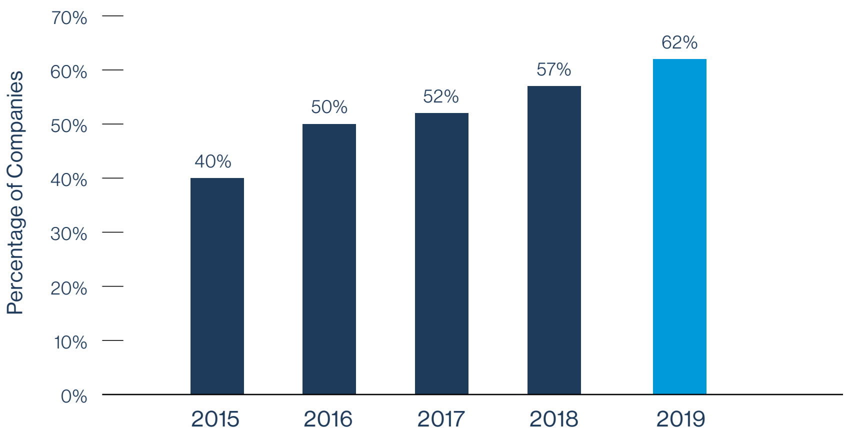
Skills and competency matrices have become an important and valuable tool in recent years, with many public companies using them to showcase the skills, experiences and capabilities of their current boards and to assist in shaping the future composition of their boards. A skills and competency matrix visually demonstrates the competencies and skills that the board, as a whole, should possess as well as which of those competencies and skills each incumbent director possesses.

As evidenced by Figure 5-1, there has been a steady increase since 2015 in the use of skills and competency matrices, with 62% of issuers from our study sample on the Composite Index and SmallCap Index currently disclosing a skills and competency matrix. Glass Lewis updated its 2019 proxy voting guidelines for TSX-listed issuers, stating that board skills matrices will be considered in its formulation of director voting recommendations at TSX 60 companies.[98] Canadian public companies, and especially TSX 60 issuers, should therefore consider developing and disclosing a skills matrices in their proxy circulars.

GUIDANCE FOR PREPARING A SKILLS MATRIX

- Identify the skills, competencies, experiences and backgrounds required to address both existing and emerging business needs
- Create specific qualifiers (i.e., breadth and depth of skills and experience required) for each skill and competency
- Define how many directors should have each skill and competency
- Map both existing and potential directors to the skills required
- Solicit feedback and approval from the entire board
- Integrate the matrix into the director renewal process
- Ensure the board critically examines the matrix on a regular basis (i.e., annually)

FIGURE 5-1:
Percentage of Issuers on the TSX Composite and SmallCap Indices Disclosing a Skills and Competency Matrix (2015–2019)



There are no specific content requirements for a skills and competency matrix, but Glass Lewis has indicated that a company should disclose sufficient information to allow investors to make a meaningful assessment of a board's overall skills and competencies. The type and scope of disclosure varies, with some companies identifying a director's top three to five skills, and other companies distinguishing between directors who are experts and directors with general or limited experience in a particular area. Furthermore, CCGG's *2018 Best Practices for Proxy Circular Disclosure* notes that companies should disclose the key skills they require from their directors as well as the company's priorities, preferences and criteria when searching for new directors.[99] CCGG's recommendations are also consistent with the Canadian Securities Administrators' (CSA) recommended best governance practices.[100] Increasingly, and as discussed in *Davies Governance Insights 2018*,[101] issuers are also being encouraged to include information in their matrices regarding each director's tenure and various diversity-related factors.

DIRECTORS WITH POOR PAST PERFORMANCE TO BE AVOIDED

Often guided by the recommendations of ISS and Glass Lewis, shareholders are increasingly voting against directors who have served on boards, or as executives, of companies with a history of poor performance, inadequate risk oversight, excessive compensation, audit or accounting issues and/or other examples of mismanagement or governance failures not aligned with the interests of shareholders. Glass Lewis also recommends that shareholders vote against directors who have a history of not fulfilling their responsibilities to shareholders at any company where they have served as a director or executive.[102] For example, Glass Lewis recommends voting against the following:

- a director who fails to attend a minimum of 75% of board and/or committee meetings without a reasonable explanation;
- a director who is also the CEO of a company where a serious and material restatement has occurred after the CEO had previously certified the financial statements;
- a director who has received two "against" recommendations from Glass Lewis for identical reasons within the past year at different companies; or
- a director who exhibits a pattern of poor oversight in the areas of executive compensation, risk management or director recruitment/nomination.[103]

INCREASES IN THE NUMBER OF FIRST-TIME DIRECTORS

There has been a growing trend toward first-time non-executive directors serving on boards. This has been largely driven by an increased demand for specific skill sets and as a means to correct gender and ethnic imbalances.[104] We expect this trend to continue in the coming years, with companies seeking directors with particular knowledge in fields such as cybersecurity, artificial intelligence, machine learning, digital transformation, customer insight, human resources/compensation, climate change and social communications.

Board Commitment and Overboarding

Board service requires significant time and attention in order for a director to properly discharge his or her responsibilities, often ranging from 200 to 300 hours a year, plus the additional time required to chair and/or serve on committees. It is essential that nominating committees take into account the demands on directors' time. In assessing whether a candidate has the time and energy needed for board service, practices and policies have largely focused on "overboarding." Overboarding refers to situations in which a director serves on an excessive number of boards. Overboarding practices and policies to date have largely been driven by guidelines from proxy advisory firms and institutional investors, and have focused on imposing a limit on the number of public company boards on which a member of the board may serve.

ISS AND GLASS LEWIS GUIDELINES

In 2019, ISS again modified its proxy voting guidelines for TSX-listed companies concerning the number of permissible directorships that a director may hold before being overboarded. A director will be overboarded if, in the case of a CEO, he or she sits on more than two public company boards (including the company of which he or she is CEO); and in the case of directors other than the CEO, he or she sits on more than five public company boards.[105] In contrast to ISS's previous policy, ISS no longer considers a director's attendance record when determining to recommend voting against a director who is overboarded.

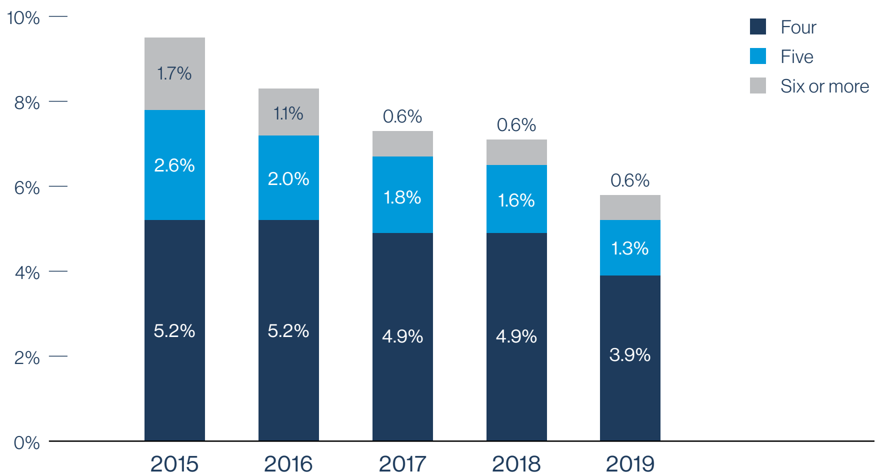
ISS and Glass Lewis are now fairly aligned with respect to their Canadian overboarding policies. Subject to certain exceptions, Glass Lewis will generally recommend a withhold vote from a director nominee if, in the case of an executive officer, he or she serves on more than two public company boards; and in all other cases, he or she serves on more than five public company boards.[106] For TSX Venture Exchange (TSXV) companies, Glass Lewis will generally permit directors to sit on up to nine boards.

TRENDS IN BOARD SERVICE

As depicted in Figure 5-2, fewer directors on Composite Index and SmallCap Index boards are serving on four or more boards today compared with prior years. These findings are not surprising considering the increasing demands placed on directors.

While the correlation between company performance and the number of overboarded directors is not necessarily clear, a recent ISS study in the United States on Russell 3000 companies found that companies without any overboarded directors had stronger economic performance than company boards with overboarded directors.[107] For the purposes of that study, an overboarded director was a CEO who served on more than two public company boards (including the company of which he or she was CEO) or a non-CEO director who served on more than four public company boards.

FIGURE 5-2:
Percentage of Directors Serving on Four or More TSX Composite and SmallCap Indices Boards (2015–2019)



Our Take: Scrutinize Directors' Motivation and Capacity to Serve

Prior to a director's appointment, all significant commitments, including other public company, private company and not-for-profit directorships, should be disclosed to the board and continuously reviewed and updated in assessing directors' performance. Although the time commitment and demands of serving as a director have likely never been greater than they are today, of course having experience serving on multiple boards can be a valuable opportunity for directors and the value of those experiences should be considered when determining overboarding policies. Looking ahead, we expect even greater investor scrutiny of directors' time commitments. Regardless of whether overboarding guidelines are appropriate proxies for determining whether a board member has sufficient time to properly discharge his or her responsibilities, we recommend the following best practices:

- Implement a formal policy on overboarding that is at least as restrictive as the ISS and Glass Lewis guidelines.
- Ensure the overboarding policy is followed when identifying and screening new directors.
- Require directors to seek prior approval from the board chair before joining any other board (which is also important for reducing or eliminating possible "interlocks" between directors, discussed further below).
- Regularly review director nomination and evaluation processes to ensure that they properly account for all of the board and committee commitments of a director.
- Ensure you understand the issuer's significant shareholders' views on overboarding, especially since many institutional shareholders have their own overboarding policies that may be more restrictive than the ISS and Glass Lewis guidelines.

Director Tenure Policies

LEGAL REQUIREMENTS

Under Canadian corporate law, directors may be elected for a term of up to three years, and staggered boards are often technically permitted. However, the TSX requires annual elections for all directors of TSX-listed companies, effectively preventing staggered boards for those issuers.[108] Although there has been increasing demand from some investors for issuers to impose term limits on directors, there are currently no statutory limits on the number of terms that a director can serve.

Nonetheless, often in an effort to foster board renewal and improve diversity, many Canadian public companies have implemented director tenure policies, with the most common policies being term limits and mandatory retirement policies. Term limits impose a maximum amount of time that a director may serve on a board, whereas mandatory retirement policies set an age limit for directors. Consistent with prior years, for issuers on the Composite Index and the SmallCap Index that have retirement policies and/or term limits, the average retirement age is 73 years and the average term limit is 13 years.

The most commonly cited advantages and disadvantages of term limits and retirement policies are as follows:

Pros

- Allow continued refreshment of directors
- Ensure board remains responsive to changing business needs and company performance
- Minimize shareholder concerns over director independence since directors are not entrenched
- Provide opportunity to enhance diversity
- Avoid difficult conversations with long-tenured directors who are underperforming or no longer providing value
- Bring fresh perspectives and reduce complacency

Cons

- Arbitrary policies eliminate experienced and potentially valuable directors
- Eliminate both effective and non-effective directors
- Long-tenured directors provide significant value, including experience, institutional knowledge and familiarity with the business
- Create an expectation that a director will serve until mandatory retirement age or tenure limit is reached

Canadian securities regulators have not adopted formal rules or regulations with respect to director tenure policies. Under National Instrument 58-101 – *Disclosure of Corporate Governance Practices* (NI 58-101) and the CBCA amendments discussed in Chapter 1, CBCA Reforms: Canadian Government Codifies Corporate Governance Practices, Canadian public companies are required to disclose only whether or not they have adopted director tenure policies or other mechanisms of board renewal and, if so, a description of the policies. If the company has not adopted such policies, it must disclose the reasons for not doing so.

TRENDS IN TERM LIMITS AND RETIREMENT POLICIES

As of 2019, 35% of Composite Index and SmallCap Index issuers had adopted a director tenure policy of some form. Of these, 45% had mandatory retirement policies, 20% had term limits and 35% had both term limits and mandatory retirement policies. These results are largely consistent with prior years, with only a marginal increase since 2015 in the number of issuers in our study sample that have adopted director tenure policies – 35% in 2019 compared with 32% in 2015.

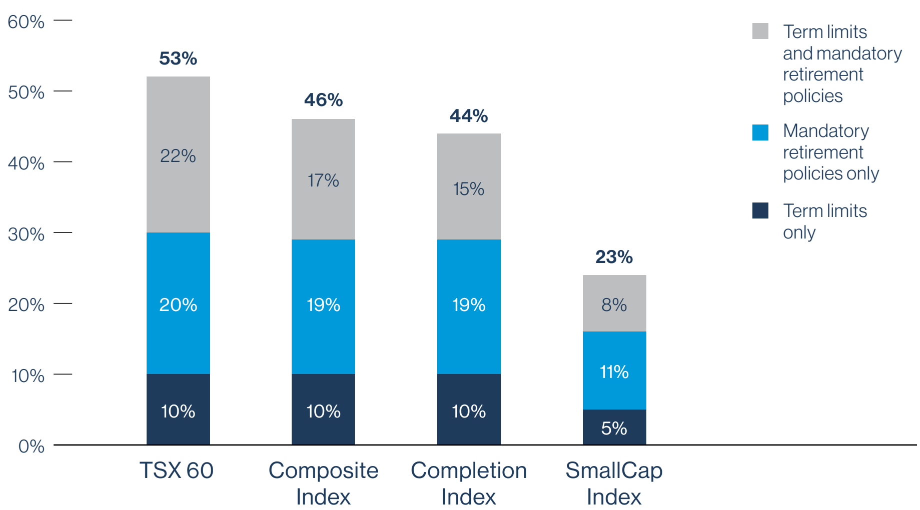
Figure 5-3 shows a breakdown of the adoption of director tenure policies by TSX 60, Composite Index, Completion Index and SmallCap Index companies. Significant takeaways include the following:

– Not surprisingly, TSX 60 issuers represent the highest proportion of companies with director tenure policies (53%).

– The proportion of issuers with director tenure policies declines as their market cap declines, with only 23% of SmallCap Index companies having a director tenure policy.

– Mandatory retirement policies are the most common form of tenure policy for each market cap tier except for TSX 60 companies, for which both term limits and mandatory retirement policies are common.

FIGURE 5-3:
Percentage of Issuers with Director Tenure Policies by TSX Index (2019)



BEST PRACTICES: DEVELOP ROBUST DIRECTOR ASSESSMENT PROCESSES

Despite the absence of formal regulation, proxy advisory firms, governance experts and other market participants generally support issuers' maintaining robust director assessment processes, as opposed to term limits or mandatory retirement policies. In particular, Glass Lewis, ISS, CCGG and the Institute of Corporate Directors (ICD) all advocate against the use of term limits and mandatory retirement policies as the principal means for ensuring high-performing boards.

We also recommend that issuers implement robust assessment processes that require boards, committees and individual directors to be evaluated at least annually, or more frequently in the event of material changes in their performance or circumstances. Although most issuers annually disclose, as required under NI 58-101, that they have such processes, in our experience there is a wide divergence in their relative robustness. For companies looking to balance the need for renewal and fresh perspectives on their board with the desire to maintain experience and institutional memory, we recommend the following:

1. Have a robust assessment process. Review your annual board assessment processes and enhance the robustness of your assessment questionnaire. Ensure the independent board chair or lead director meets one-on-one with each director to get their views concerning their own and other directors' performances.

2. Require notice of material changes in circumstances. Require directors to provide prompt notice to the board chair when they experience a material change in their circumstances, to assess whether those changes may affect the performance of their duties on the board and its committees.

3. Consider independent external reviews. For boards that have a high number of long-tenured directors and/or difficulty in assessing and addressing potential performance issues, consider engaging an outside "board doctor" to conduct the assessment and make recommendations to the board.

4. Consider whether tenure limits are appropriate. For some companies, term limits and/or retirement policies may be appropriate. Companies that already have or are considering implementing such policies should consider the views of their significant shareholders and of proxy advisory firms; be aware that while most policies permit waivers of the applicable tenure requirement, doing so may trigger negative voting recommendations from ISS and/or Glass Lewis. As an alternative, consider imposing limits on the period of time a person may serve as chair or lead director of the board or as a committee chair.

5. Assess independence based on tenure. As discussed further below, tenure is a factor that should be relevant to a board's consideration of whether a director continues to be independent. While not necessarily the case, boards should consider whether the length of a director's tenure could reasonably be expected to interfere with the director's exercise of judgment.

Glass Lewis recommends that boards of TSX-listed issuers have a minimum of five directors to ensure sufficient diversity of views and experience, and a maximum of 20 directors to ensure that decisions are made efficiently and effectively.

6. Consider director voting outcomes. Boards should take seriously, and investigate, circumstances in which one or more directors receive relatively lower levels of support for their election at annual shareholders' meetings. While voting outcomes may not necessarily correlate with the director's performance or commitment, they are indicators of investors' views of an issuer's directors; sustained lower level votes over more than one year are likely important signals that refreshment may be necessary.

Board Size

LEGAL REQUIREMENTS

The composition of a company's board is governed by the corporate laws of the jurisdiction where the company exists. In Canada, generally public companies must have at least three directors.

ISS AND GLASS LEWIS GUIDANCE

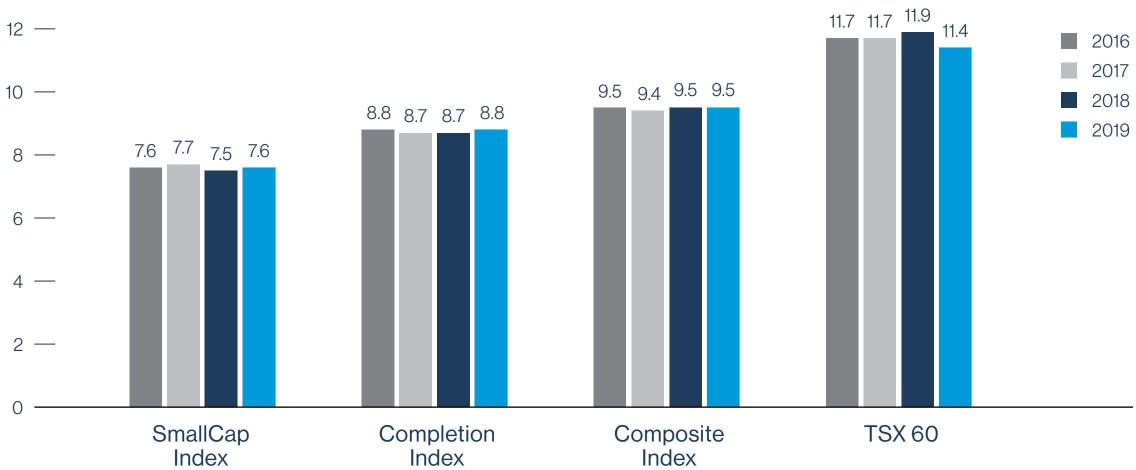
Although there is no universally accepted ideal board size in Canada, Glass Lewis recommends that boards of TSX-listed issuers have a minimum of five directors to ensure sufficient diversity of views and experience, and a maximum of 20 directors to ensure that decisions are made efficiently and effectively. Glass Lewis will generally recommend withholding votes from the chair of the nominating and/or governance committee (or the board chair in the absence of such committees) at TSX companies with fewer than five directors and TSXV companies with fewer than four directors. For boards with more than 20 directors, Glass Lewis will generally recommend withholding votes from the chair of the nominating committee (or the governance committee in the absence of a nominating committee).[109]

ISS does not provide organizations with guidance on board size other than noting that boards should be large enough to accommodate diversity, expertise and independence, yet small enough to maintain active collaboration and participation.[110]

TRENDS IN BOARD SIZE

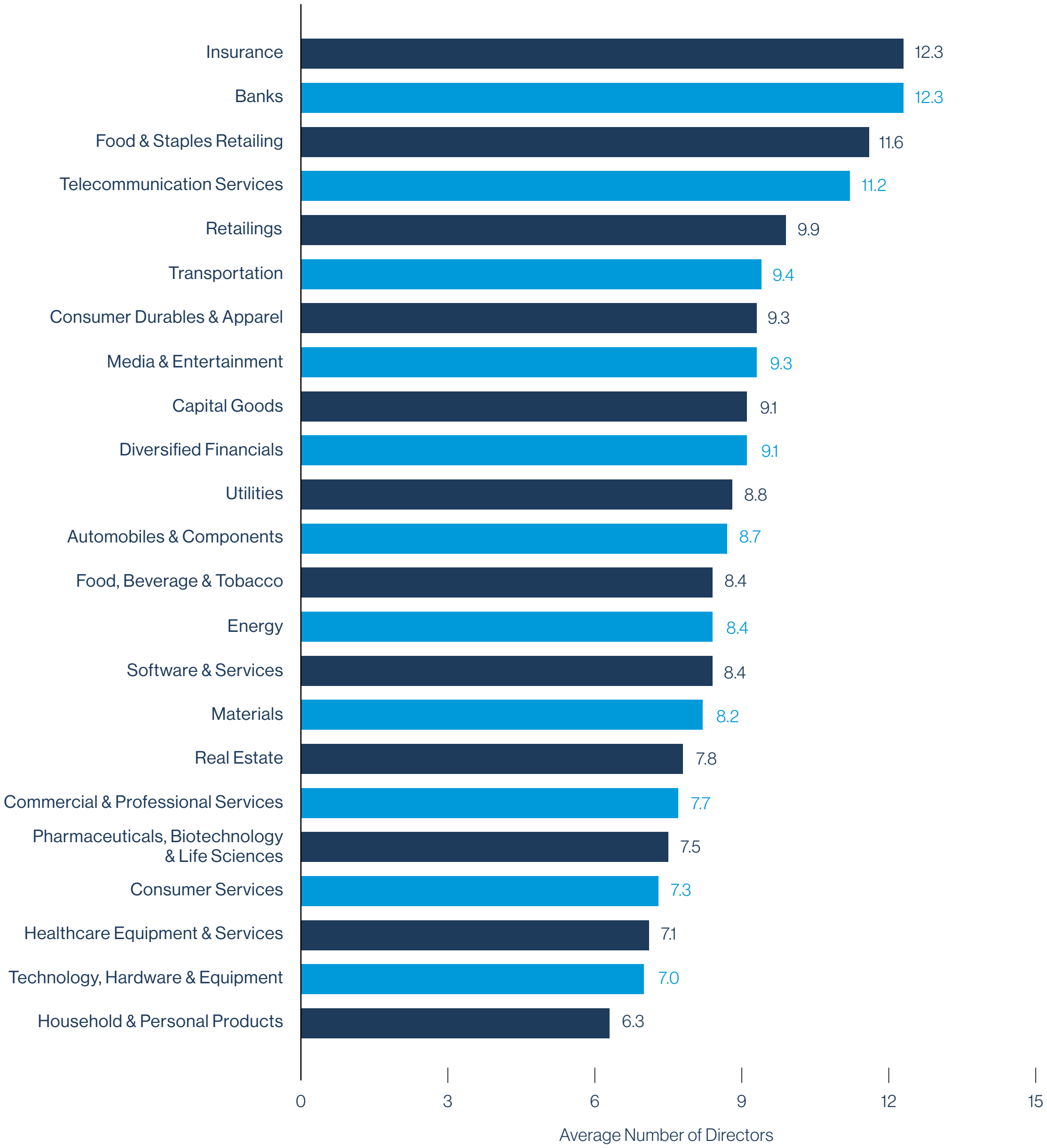
As shown in Figure 5-4, issuers on the Composite Index and the SmallCap Index combined typically have an average of between seven and 12 directors. The average board size of issuers generally increases as the market cap of the issuer increases. In 2019, the average board size of an issuer in our study sample was nine directors, with the size of such boards ranging between three and 16 directors (except for one company that had 22 directors). The majority of issuers across all four indices had a board size of between seven and nine directors.

FIGURE 5-4:
Average Board Size by TSX Index (2016-2019)



As depicted in Figure 5-5, the average board size of issuers on the Composite Index and the SmallCap Index varies by industry, with those in insurance, banking, and food and staples retailing having the largest boards; those in households and personal products, technology hardware and equipment, and healthcare equipment and services have the smallest boards.

FIGURE 5-5:
Average Board Size by Industry on TSX Composite and SmallCap Indices (2019)



Our Take: Ensure the Board Has a Diverse Mix of Skills

At the end of the day, the ideal size of a board will vary by company and depend on a range of factors, including market cap, the complexity of the company's business, the company's strategy and plans, geographical footprint, required skills and the presence of significant or controlling shareholders that may have board nomination rights. Studies have indicated that smaller boards outperform larger boards for several reasons, including the fact that smaller boards can be more decisive and cohesive, and can foster better debates, more efficient decision-making and more effective management oversight.[111] That said, the key factor in determining the right board size will be to ensure that the board has the right mix of skills, knowledge and experience to guide a company in the proper direction. To do so, we recommend that boards develop, implement and annually review (and if appropriate, revise) a robust skills and competency matrix, having regard to the business's evolving needs and strategies. Doing so often better situates companies to both assess the effectiveness of their current boards and ensure that new directors are selected objectively in furtherance of creating a high-performing board.

Independence

OVERVIEW OF INDEPENDENCE CRITERIA

The need for independent directors on Canadian public company boards is a well-established principle, with securities regulators and the TSX providing specific regulation and many proxy advisory firms offering additional guidance, which influences their voting recommendations. The principal purposes of director independence requirements are to help ensure that directors' interests are aligned with the shareholders' interests as opposed to management's and to help boards maintain objectivity in their strategic decision-making.

Although the TSX and the Canadian securities regulators have slightly different definitions of independence, they are both concerned with relationships that could interfere with a director's ability to act objectively and without bias, and to fulfill their fiduciary duty to act in the best interests of the company.

Canadian securities regulators, through NI 58-101, National Policy 58-201 – *Corporate Governance Guidelines* (NP 58-201) and National Instrument 52-110 – *Audit Committees* (NI 52-110), have defined an independent director as an individual who has no direct or indirect "material relationship" with the company; a material relationship is any relationship that could, in the view of the company's board, be reasonably expected to interfere with the exercise of such director's independent judgment. NI 52-110 sets out a number of relationships between a director and the issuer that are deemed to give rise to a material relationship, including where a director is or has been an employee or executive officer of the issuer or a subsidiary of the issuer within the last three years, and advisers or consultants to the issuer, such as lawyers, accountants and bankers.

The TSX defines an independent director as an individual who (i) is not a member of management and is free from any interest and any business or other relationship that in the opinion of the TSX could reasonably be perceived to materially interfere with the director's ability to act in the best interest of the company; and (ii) is a beneficial holder, directly or indirectly, or is a nominee or associate of a beneficial holder, of 10% or less of the votes attaching to all issued and outstanding securities of the company. The TSX considers all relevant factors in assessing the independence of a director; however, as a general rule, the following are not considered independent: (i) a person who is currently, or has been within the past three years, an officer, employee of or service provider to the company or any of its subsidiaries or affiliates; or (ii) a person who is an officer, employee or controlling shareholder of a company that has a material business relationship with the company.[112]

Although the TSX and the Canadian securities regulators have slightly different definitions of independence, they are both concerned with relationships that could interfere with a director's ability to act objectively and without bias, and to fulfill his or her fiduciary duty to act in the best interests of the company. ISS, Glass Lewis and CCGG, among others, have published additional definitions of independence; while their definitions are generally consistent with those above, with lookback periods varying between three to five years, they also include several additional indicia that may render a director not independent under their policies.

BEST PRACTICES: MAINTAIN A MAJORITY INDEPENDENT BOARD

1. Ensure compliance with independence standards for boards. Table 5-1 outlines the minimum independence requirements set out by the CBCA, the OBCA, the CSA, the TSX, ISS, Glass Lewis, CCGG and *The Globe and Mail*'s Board Games Report. The general recommendation is that boards should have a majority of independent directors. Notable exceptions include the following: (i) CCGG recommends that at least two-thirds of a board be independent; (ii) *The Globe and Mail*'s Board Games Report provides full "marks" only for boards that are two-thirds independent (half marks for boards that have a majority of independent directors and zero marks if a majority of the board is not independent); and (iii) Glass Lewis recommends that at least two-thirds of a board for Composite Index issuers be independent.

TABLE 5-1:
Minimum Canadian Independence Requirements

Guidelines	Two Independent Directors	One-Third Independent Directors	Majority Independent Directors	Two-Thirds Independent Directors
CBCA (Public Companies)*	✓			
OBCA (Public Companies)**		✓		
Canadian Securities Laws (NP 58-201; NI 52-110)			✓	
TSX (TSX Company Manual)	✓			
ISS			✓	
Glass Lewis (General)			✓	
Glass Lewis (Composite Index)				✓
CCCG				✓
The Globe and Mail's Board Games Report (2018)[113]	Full "marks" (four marks) are awarded for a board that is two-thirds independent. Two marks are awarded if more than half of the board is independent. Zero marks are awarded if the majority of the board is not independent.			

* A CBCA public company must have at least two directors on its board who are not officers or employees of the company or any of its affiliates.

** An OBCA public company must have at least one-third of the directors on its board who are not officers or employees of the company or any of its affiliates.

Although independent directors play an important role, the general consensus from proxy advisory firms is that boards should not be entirely composed of independent directors since company executives (present or former) have certain company-specific knowledge and experience that make them extremely valuable board members. Since a director's independence can change over time, boards should review the proportion of independent directors on an annual basis to ensure that the appropriate minimum thresholds are continuously achieved.

When conducting independence assessments, many boards focus on the "bright-line" relationship tests in NI 52-110. It is important to remember that this is only part of the picture. The objective test in NI 52-110 that requires boards to consider whether there is any other relationship that could reasonably be expected to interfere with the exercise of a member's independent judgment will often require consideration of other personal, professional, commercial, financial and familial relationships, pecuniary and otherwise, that may affect that judgment. Layered on top of this, many issuers have codes of conduct that impose even higher independence standards, requiring directors to avoid relationships or interests that could actually, potentially or reasonably be perceived to undermine their ability to act impartially, objectively and without bias. Boards should consider the full array of circumstances of each director to ensure directors are, and will be perceived to be, independent by the issuers' investors and other stakeholders.

2. Hold regular meetings of independent directors. A public company's independent directors should hold regularly scheduled meetings that non-independent directors and members of management do not attend.

3. Make key board committees entirely independent. As a general rule, all board committees should have at least a majority of independent directors. However, a company's audit, compensation, nominating and governance committees should be composed entirely of independent directors. NP 58-201, NI 52-110 and Glass Lewis all recommend that, subject to certain limited exceptions, these committees be entirely independent. ISS also indicates that those committees should have a majority of independent directors and they should not contain executive directors, controlling shareholders, or non-employee officers of the company or its affiliates that are among the five most highly compensated officers.

4. Limit interlocking director relationships. Boards should seek to minimize their number of "interlocking" director relationships. An interlock occurs when two or more directors also serve as fellow directors of another company. Glass Lewis specifically recommends withholding votes from any directors who have interlocking director relationships with one of the other company executives, whereas CCGG recommends simply limiting the number of director interlocks through formal policies.[114] Consider codifying in the issuer's governance guidelines that there be no more than one board interlock at any given time.

Since a director's independence can change over time, boards should review the proportion of independent directors on an annual basis to ensure that the appropriate minimum thresholds are continuously achieved.

5. Separate the roles of board chair and CEO. Most industry experts and proxy advisory firms, including ISS, Glass Lewis and CCGG, support separating the roles of board chair and CEO. Doing so is important because each role has different responsibilities and objectives. The board chair is responsible for leading the board, evaluating management and company performance, setting executive pay and ensuring that the organizational strategy is in the long-term best interests of the corporation; the CEO, on the other hand, is responsible for leading management, maintaining the day-to-day operations, and developing and implementing an adequate business strategy. Not separating the roles of chair and CEO can obstruct the proper checks and balances on management and may lead to less scrutiny on company performance.

Not separating the roles of chair and CEO can obstruct the proper checks and balances on management and may lead to less scrutiny on company performance.

As an alternative, both ISS and Glass Lewis, among others, support the appointment of an independent lead director with a broad range of powers akin to those typically held by the chair, including the authority to call board meetings, to set the agenda for board meetings and to engage with shareholders.[115]

Diversity on Boards

Diversity initiatives, and specifically those relating to gender, continue to be a hot topic of discussion. Updates to ISS's and Glass Lewis's proxy voting guidelines this past year, together with the announced amendments to the CBCA by the federal government (discussed in Chapter 1, CBCA Reforms: Canadian Government Codifies Corporate Governance Practices) reflect the continued focus on, and evolution of, diversity initiatives relevant to issuers and their boards. For example, whereas previous ISS policy on gender diversity applied solely to Composite Index issuers, ISS expanded its 2019 proxy voting guidelines to apply to all "widely held" companies.[116] ISS will typically recommend withholding votes from the chair of the nominating committee or equivalent if the board has no female members and the company has not disclosed a formal written gender diversity policy.[117] Glass Lewis will generally recommend voting against the chair of the nominating committee if the board has no female members.[118]

A more detailed discussion of issues relating to diversity can be found in Chapter 6, Navigating Gender Diversity in 2019. It is clear today that TSX companies that do not have any female directors or a formal diversity policy are truly the exception to the norm. Diversity will and should continue to play a large role in board composition practices and issuers' overall corporate governance framework.

Board Committees: Building Expertise

While the prevalence of, and the requirements and rules for, certain board committees, (including audit, compensation, nominating and corporate governance committees) are clearly established, we are starting to see companies establish other types of standing board committees, particularly environmental, social and governance (ESG) committees and cybersecurity committees.

ESG is a broad concept covering a wide range of issues, including socially responsible investing, sustainable investing and consideration of general environmental and social factors such as climate change, labour practices, community relations and business ethics. From a governance perspective, cybersecurity relates to the ability of a company to handle the potential negative outcomes associated with cyberattacks, which include attempts to compromise the confidentiality, integrity and availability of computer data or systems.[119]

ESG is a broad concept covering a wide range of issues, including socially responsible investing, sustainable investing and consideration of general environmental and social factors such as climate change, labour practices, community relations and business ethics.

Securities regulators and proxy advisory firms across the world have been focusing on ESG and cybersecurity issues in recent years. Some notable Canadian developments include the following:

- CCGG published *The Directors' E&S Guidebook* (*E&S Guidebook*) in May 2018, providing insights and recommendations for effective board oversight and company disclosure of ESG matters.
- The Ontario Securities Commission (OSC) issued its 2018-2019 statement of priorities, which references a focus on the "growing investor interest in climate change, along with environmental, social and governance (ESG) factors and the need for enhanced ESG disclosure by companies."[120] Although the OSC's 2019-2020 statement of priorities does not prioritize ESG issues, the OSC noted that ESG issues remain relevant and that it would continue to monitor developments and work with the CSA to identify opportunities to improve ESG-related disclosure. Their work culminated in the recent release of CSA Staff Notice 51-358 – *Reporting of Climate Change-related Risks*, discussed further in Chapter 2, Climate Change and Sustainability: New Standards for Sustainability Reporting and Disclosures. The OSC also acknowledged that cyber resilience and data security remain key areas of focus.
- The CSA's 2016-2019 Business Plan identified cybersecurity as a priority area, and the CSA continues to undertake initiatives to integrate cyber-related activities into its work, to better understand the challenges and level of preparedness of companies in respect of cyberattacks and to improve the overall resilience of the capital markets. The CSA has issued several publications regarding cyber risks in recent years, including CSA Staff Notice 11-332 – *Cyber Security*; CSA Staff Notice 11-336 – *Summary of CSA Roundtable on Response to Cyber Security Incidents*; CSA Staff Notice 11-338 – *CSA Market Disruption Coordination Plan*; and CSA

Multilateral Staff Notice 51-347 – *Disclosure of Cyber Security Risks and Incidents* (CSA Staff Notice 51-347). Moving forward, the CSA has indicated that managing cybersecurity remains a key priority.[121]

– Both ISS and Glass Lewis now consider ESG issues in their proxy voting guidelines. Glass Lewis recommends that companies ensure appropriate board oversight of material risks, including ESG issues, to their operations. For large market cap companies and where material oversight issues are identified, Glass Lewis will review the company's governance practices and will disclose instances in which ESG oversight has not been clearly defined. If ESG issues have not been properly addressed by a board, Glass Lewis may consider recommending that shareholders vote against the directors responsible for ESG oversight.[122] Similarly, ISS may recommend voting against the directors responsible for ESG oversight when there are material failures of governance, stewardship, risk oversight or fiduciary responsibilities, including the failure to adequately manage or mitigate ESG risks.[123]

In light of the increased attention on ESG and cybersecurity, companies should consider how best to ensure that there is adequate oversight of these issues at the board level. At a minimum, companies should have some form of oversight framework. Although we are starting to see the more frequent adoption of dedicated ESG and cybersecurity committees, the most effective and adequate framework will vary from company to company, with the board as a whole ultimately being responsible for proper oversight.

CCGG's *E&S Guidebook* recommends that directors consider the nature of ESG issues when selecting the appropriate committee(s) to be accountable for these issues; with some companies requiring dedicated board committees.[124] CCGG's *E&S Guidebook* highlighted one energy company to illustrate the potential comprehensiveness of an oversight framework. For this energy company, the audit committee is responsible for cyber risk; the safety and reliability committee is responsible for operational risks (spills, releases, incidents); and the CSR committee is responsible for stakeholder engagements and climate strategy and reporting. The compensation committee in turn considers how compensation programs affect ESG oversight, and the nominating committee determines the necessary skills required of directors to adequately oversee ESG issues.

From a cybersecurity perspective, several authorities, including the International Organization of Securities Commissions, support the use of dedicated committees.[125] Notwithstanding the foregoing, audit committees are most often identified as being responsible for overseeing cybersecurity risks, with other alternatives being a risk committee, the board and management as a whole, and the chief financial officer or the head of information technology.[126] In any case, boards should ensure the committees responsible for these areas at least have the required skills and expertise to manage their responsibilities.

In light of the increased attention on ESG and cybersecurity, companies should consider how best to ensure that there is adequate oversight of these issues at the board level.

CHAPTER 06

Navigating Gender Diversity in 2019

Canadian public companies remain under sustained pressure to improve gender diversity. In this chapter, we provide a snapshot of the current state of gender diversity among Canadian public companies, which reveals meaningful progress on a number of diversity-related metrics. We also explore how institutional investors continue to incorporate diversity-related guidelines into their voting decisions; with increased investor attention on promoting gender diversity, in 2019, for the first time in Canada, a majority of investors voted in favour of a shareholder proposal relating to gender diversity. We also discuss the ever-expanding framework of gender diversity–requirements and guidelines from corporate and securities regulators, the Toronto Stock Exchange, proxy advisers and governance watchdogs, and provide practical tips on how boards and senior management can continue making headway in increasing diversity.

Top Developments in 2019

Even though it's been five years since the Ontario Securities Commission (OSC) implemented the comply-or-explain disclosure requirements on gender diversity, regulators, stock exchanges, institutional shareholders, governance watchdogs and the media keep demanding more disclosure and better gender diversity practices from Canadian companies.

The regulatory framework and the state of gender diversity for Canadian publicly traded companies continue to evolve, requiring boards to take into account an ever-expanding array of regulations and guidelines when assessing and disclosing their diversity-related policies and practices. Significant developments this year include the following:

- Nearly one-quarter of board seats of companies on the Toronto Stock Exchange (TSX) Composite and SmallCap indices are occupied by women.
- Nearly three-quarters of companies on the TSX Composite and SmallCap indices have a gender diversity policy.
- New diversity disclosure requirements applicable to federally incorporated Canadian public corporations will apply in the 2020 proxy season.
- The first shareholder proposal on diversity in Canada passed.
- Many institutional investors now include a gender diversity component in their proxy guidelines.
- Glass, Lewis & Co. (Glass Lewis) may vote against the nominating committee chair if the board has not adopted a gender diversity policy.

The regulatory framework and the state of gender diversity for Canadian publicly traded companies continue to evolve, requiring boards to take into account an ever-expanding array of regulations and guidelines when assessing and disclosing their diversity-related policies and practices.

Snapshot: Gender Diversity Trends

We continue to track developments in gender diversity disclosure since the 2015 implementation by the OSC of comply-or-explain disclosure requirements under National Instrument 58-101 – *Disclosure of Corporate Governance Practices* (NI 58-101).

BOARDS OF DIRECTORS

Based on our review of companies on the TSX Composite and SmallCap indices (see Table 6-1), many of the data points – including the percentage of newly elected directors who are women – show only a modest increase in 2019 (32% of newly elected directors in 2019 are women, compared with

28% in 2018). However, meaningful progress has been seen on a number of other fronts, in particular with respect to the percentage of issuers with written gender diversity policies (up from 37% in 2015 to 73% in 2019); the number of issuers that put no women up for election (down from 32% in 2015 to 6% in 2019); and the number of issuers that have adopted gender targets (up from 11% in 2015 to 35% in 2019). Of note, according to a recent report published by *The Wall Street Journal*, as of July 2019, there are no longer any all-male boards among S&P 500 companies in the United States.[127] At the time of writing this report, Canada has reached a similar milestone with each issuer on the Composite Index having at least one woman on their board. There remain around 20 Canadian issuers on the SmallCap Index that still have no women on their board.

TABLE 6-1:
Diversity Progress at Issuers on the TSX Composite and SmallCap Indices (2015–2019)

	2019	2018	2017	2016	2015
Board seats held by women	24%	21%	19%	18%	15%
Newly elected directors (by board seats) who were women	32%	28%	24%	25%	26%
Issuers that put at least one woman up for election	94%	87%	80%	77%	68%
Issuers that put two or more women up for election	61%	51%	48%	44%	37%
Issuers that put no women up for election	6%	13%	20%	23%	32%
Issuers with diversity policies	73%	61%	51%	48%	37%
Issuers with diversity targets	35%	24%	19%	16%	11%

EXECUTIVE OFFICERS

The Canadian Securities Administrators (CSA) also provided an update in September 2018, in Multilateral Staff Notice 58-310 – *Report on Fourth Staff Review of Disclosure regarding Women on Boards and in Executive Officer Positions* (2018 CSA Review), based on the CSA's review of 648 TSX-listed companies that had year-ends between December 31, 2017 and March 31, 2018, and that had filed information circulars or annual information forms by July 31, 2018. The 2018 CSA Review indicated that 66% of companies had at least one woman in an executive officer position, which is a modest improvement from 62% in 2017 and 60% in 2015. The CSA also presented two new statistics relating to executive officers in its review: the proportion of issuers with a female CEO (see Figure 6-1) and the proportion of issuers with a female CFO (see Figure 6-2).

FIGURE 6-1:
Proportion of Issuers with a Female CEO

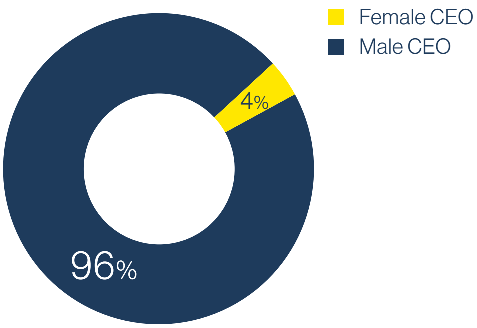
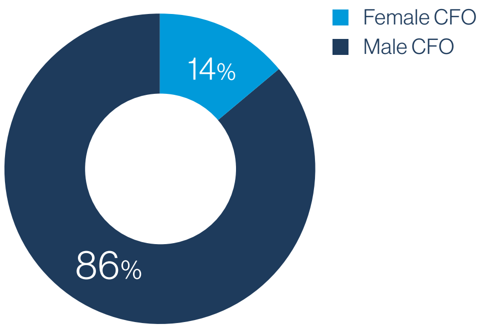


FIGURE 6-2:
Proportion of Issuers with a Female CFO



Source: 2018 CSA Review

Global Reach: Beyond Board Representation

Equileap, a non-profit organization based in Amsterdam, tracks, compares and ranks companies around the world based on 19 criteria, including metrics ranging from the number of women on boards of directors and in executive positions to equal pay and parental leave policies (Equileap Criteria).[128] The Equileap Criteria include 19 data clusters divided into four categories that measure (i) gender balance in the workforce of a company, (ii) equal compensation and work-life balance, (iii) policies promoting gender equality and (iv) commitment to women's empowerment, transparency and accountability.

Equileap scores and ranks the covered companies' commitment to gender equality using a four-stage approach. The first stage measures 12 criteria against publicly available data (including gender balance at the non-executive, executive and senior management levels and in the workforce; promotion and career development opportunities; and seven types of policies in the workplace that promote equal treatment and opportunities for men and women). The second stage involves a subset of these companies completing a questionnaire about their performance on all of the primary first-stage criteria, plus seven additional criteria (including questions relating to parental leave policies, flexible work schedules and combatting sexual harassment). The third stage awards companies points on a scale from 0 to 100, primarily based on which companies perform best on the promotion and career development of women. The final stage involves conducting searches to determine whether any of the covered companies have any legal judgments against them in the previous two years relating to sexual harassment or discrimination (which results in those companies being marked in the ranking with a notation).[129]

Equileap's *2018 Gender Equality Global Report & Ranking* (Equileap 2018 Report)[130] includes a database of 3,206 public companies (including issuers in Canada and the United States), which all have a primary listing on a stock exchange in one of 23 developed economies around the world and a market capitalization above US$2 billion. The highest-ranking one-third of those companies, based on the Equileap Criteria and the process described above, were then researched in depth by Equileap's team, to compile the 2018 Equileap top 200 ranking (Top 200 Ranking).

Of the covered Canadian companies, 9% made the Top 200 Ranking. On average, these Canadian companies scored 34% based on the Equileap Criteria; those on the TSX 60 scored an average of 29%. Interestingly, despite the fact that Canada arguably has a more robust disclosure regime concerning gender diversity than the United States, the Equileap 2018 Report suggests Canadian issuers are not faring any better than their U.S. counterparts. For example, 11% of covered U.S. companies made the Top 200 Ranking; on average, these U.S. companies scored 35% based on the Equileap Criteria, and all of those U.S. companies on the S&P 100 Index scored an average of 45% in their rankings.

To see how Canada fared against other countries around the world, see Figure 6-3, from the Equileap 2018 Report.

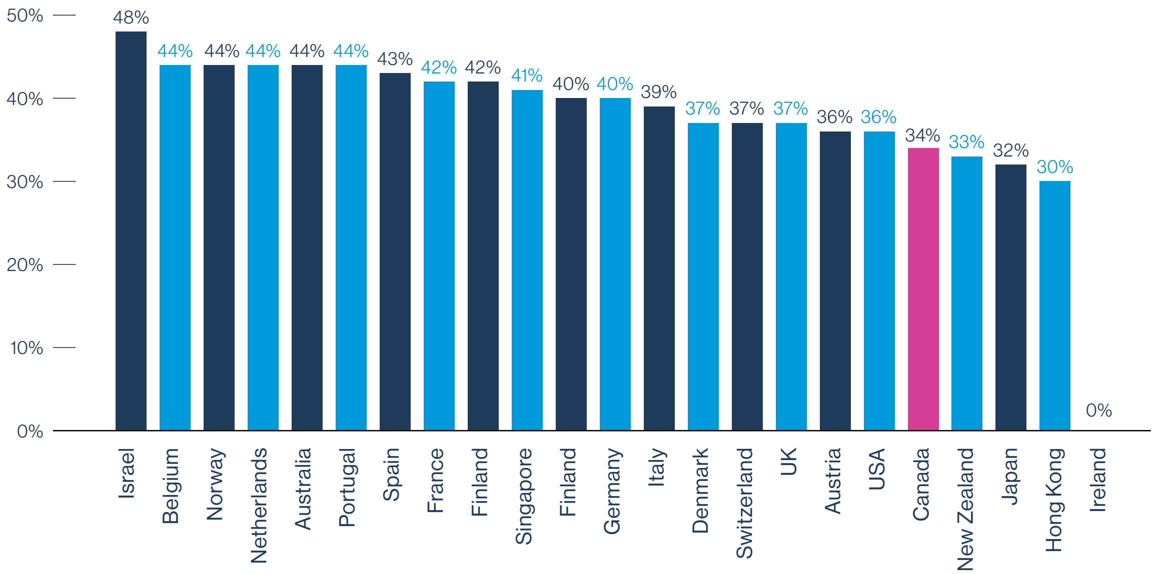
TD SAYS *SMALL* COMPANIES CAN HAVE A *BIG* IMPACT ON CANADA'S RANKING

The TSX has a higher prevalence of resource issuers and smaller companies than the S&P 500 Index in the United States. For example, small resource firms represent 30% of all board seats on the Composite Index, compared with just 12.5% on the U.S. Benchmark Index.[131] This could in part explain why Canada is lagging behind the United States in the representation of women on boards: smaller companies have slower turnover of board seats and therefore fewer opportunities to change the status quo, and they are also more likely to cite limited resources for candidate searches.

This lends support to the claim by a Toronto-Dominion Bank (TD) economist, who says that "ultimately, to move the needle in corporate Canada as a whole, stronger headway needs to be made among smaller firms, and disproportionately within the resource sector,"[132] which tends as an industry to have lower representation of women.

TD estimates that if all of Canada's small firms were to hit the tipping point of having three women on their boards, that would move the representation of women on boards of Composite Index issuers up by 10%, to 34%.

FIGURE 6-3:
Equileap's Gender Equality Global Comparison (2018)



Source: Equileap 2018 Report

Navigating Canada's Increasingly Complex Diversity Framework

To help executives and boards navigate the myriad of rules, guidance and best practices surrounding gender diversity in Canada, the following section synthesizes the requirements and guidelines on gender diversity from corporate and securities regulators, the TSX, proxy advisers and certain governance commentators.

1 **Disclose whether your company has adopted a written policy relating to the identification and nomination of women on the board.**

a. If your company has *not* adopted such a policy, then disclose why your company has not done so.
b. If your company has adopted such a policy, your company must disclose (i) a short summary of the policy's objectives and key provisions; (ii) the measures taken to ensure that the policy has been effectively implemented; (iii) annual and cumulative progress by your company in achieving the objectives of the policy; and (iv) whether and, if so, how the board of your company or its nominating committee measures the effectiveness of the policy.

This disclosure is required under NI 58-101 for reporting issuers (other than venture companies) in all provinces and territories in Canada, other than British Columbia and Prince Edward Island. If you are a reporting issuer, then this disclosure must be provided to your shareholders at every annual meeting, and in the management information circular whenever management solicits proxies from the company's securityholders to elect directors to the board.

Section 472 of the *TSX Company Manual* requires companies listed on the TSX that are subject to NI 58-101 to disclose their corporate governance practices in accordance with NI 58-101. The TSX penalties for non-compliance include requiring such issuers to publish amended disclosure in their next quarterly report and publishing the names of the non-compliant issuers with a request for amended disclosure. Continued non-compliance may result in suspension or delisting. Listed companies that evidence a "blatant and consistent disregard" of the TSX's disclosure requirements may be referred to the OSC and may be subject to other legal proceedings.

In *Davies Governance Insights 2018*,[133] 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 with respect to diversity among directors and senior management to their shareholders at every annual meeting. The amendments to the CBCA and associated regulations (CBCA Amendments) require the same gender diversity–related information from all CBCA public companies (including those on the TSX Venture Exchange (TSXV)) as under NI 58-101, but they go further, also requiring disclosure about designated groups under the *Employment Equity Act* (i.e., women, Aboriginal peoples, persons with disabilities and visible minorities). The CBCA Amendments come into force on January 1, 2020, which means CBCA public corporations will be required to comply with these disclosure requirements in the 2020 proxy season.[134] Further details about these and other CBCA Amendments can be found in Chapter 1, CBCA Reforms: Canadian Government Codifies Corporate Governance Practices.

The amendments to the CBCA and associated regulations require the same gender diversity–related information from all CBCA public companies as under NI 58-101, but they go further, also requiring disclosure about designated groups under the *Employment Equity Act*.

2 **Consider adopting a formal written diversity policy, and, when preparing the policy, consider the following:**

a. include measurable goals and/or targets denoting a firm commitment to increasing board gender diversity within a reasonable period of time;
b. include a clear commitment to increasing board gender diversity; and
c. refrain from using boilerplate or contradictory language.

Institutional Shareholder Services, Inc. (ISS) and Glass Lewis continue to make voting recommendations relating to gender diversity disclosure and progress based on their additional gender-related guidelines developed since 2015.

Based on ISS's *Proxy Voting Guidelines for TSX-Listed Companies* (Canada),[135] ISS will *generally* recommend withholding votes from the chair of the nominating committee (or equivalent), or the chair of the board if no committee chair has been identified, where (i) a company has not disclosed a formal written gender diversity policy and (ii) there are no female directors on the board. This policy applies to widely held companies (i.e., Composite Index issuers, as well as other companies that ISS designates as such based on the number of ISS clients holding securities of the company). The policy does not apply to companies that are newly publicly listed within the current or prior fiscal year, companies that have transitioned from the TSXV within the current or prior fiscal year, or companies with four or fewer directors.

In Glass Lewis's *2019 Proxy Paper Guidelines for Canada*,[136] Glass Lewis *may* recommend voting against the nominating committee chair if the board 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 vote against other nominating committee members. Glass Lewis will also generally recommend voting against the nominating committee chair of a board that has no female members. When making these voting recommendations, Glass Lewis will review a company's disclosure of its diversity considerations and may refrain from recommending that shareholders vote against directors when the companies are outside the Composite Index or when boards have provided a sufficient rationale for not having any female directors. Such rationales may include a disclosed timetable for addressing the lack of diversity and any restrictions in place regarding the board's composition, such as nomination agreements with significant investors.

Given these recommendations from ISS and Glass Lewis, it is not surprising that we have witnessed a meaningful increase in the number of companies that have recently adopted gender diversity policies (73% in 2019 versus 61% in 2018).

The Canadian Coalition of Good Governance (CCGG) *2018 Board Gender Diversity Policy* also indicates that boards should adopt a written gender diversity policy, pointing out that companies with a written policy tend to have a higher percentage of women on boards than those without.[137] CCGG's policy advocates for the CSA to move to prescribe written gender diversity policies as a best practice in its corporate governance guidelines.

3 **Disclose whether and, if so, how the board or the nominating committee considers the level of representation of women on the board in identifying and nominating candidates for election or re-election to the board. Disclose whether and, if so, how your company considers the level of representation of women in executive officer positions when making executive officer appointments. If your company does not consider the level of representation of women in either respect, then disclose your company's reasons for not doing so.**

This disclosure is required by NI 58-101, the *TSX Company Manual* and the CBCA Amendments. Related to this requirement, boards should be aware that NI 58-101 also requires issuers to describe the process by which the board identifies new directors for nomination.

The Canadian Coalition of Good Governance 2018 Board Gender Diversity Policy also indicates that boards should adopt a written gender diversity policy, pointing out that companies with a written policy tend to have a higher percentage of women on boards than those without.

Securities regulators continue to look at the more general disclosure requirements for identifying and nominating candidates to the board, recognizing that many issuers provide boilerplate disclosure about this process, including with respect to how the representation of women fits into it. Issuers should consider enhancing their disclosures in this area, including providing greater transparency about whether the board has a formal policy on the recruitment of board candidates; how director candidates are sourced, screened and selected; how criteria (including diversity) are established to identify the core competencies sought of prospective directors (including having regard to any established skills matrix); and the role of the board chair and the issuer's CEO in the director recruitment process. Enhanced disclosure may be required in due course, and in any event this appears to be an area that many investors are seeking more information about. Additional guidance concerning disclosure on the director nomination process is contained in CSA Staff Notice 58-306 – *2010 Corporate Governance Disclosure Compliance Review.*

4 **Disclose whether your company has adopted a target regarding women on the board and in executive officer positions. A target means a number or percentage, or a range of numbers or percentages, adopted by your company, of women on the board or in executive officer positions by a specific date. If your company has adopted a target, then disclose (i) the target and (ii) the annual and cumulative progress of your company in achieving the target. If your company has not adopted a target, then disclose why it has not done so.**

This disclosure is required by NI 58-101, the *TSX Company Manual* and the CBCA Amendments.

U.S. UPDATE: SEC COMPLIANCE AND DISCLOSURE INTERPRETATIONS ON DIVERSITY

On February 6, 2019, the U.S. Securities and Exchange Commission (SEC) updated its Compliance and Disclosure Interpretations of Regulation S-K to clarify the disclosure of "self-identified diversity characteristics" required under item 401 (Directors, Executive Officers, Promoters and Control Persons) and under item 407 (Corporate Governance) with respect to director nominees.

To the extent that a board or nominating committee considered the "self-identified diversity characteristics" of an individual who consented to the disclosure of those characteristics, SEC staff expects a company's discussion under item 401 to identify those characteristics and how they were considered. SEC staff also expects any description of diversity policies under item 407 to include a discussion of how a company considers the self-identified diversity characteristics of nominees, and any other qualifications a diversity policy takes into account, such as diverse work experiences, military service or socio-economic or demographic characteristics.[138]

Companion bills have also been introduced into the U.S. House of Representatives and the U.S. Senate that would require every U.S. public company to disclose in proxy statements, among other things, data regarding the racial, ethnic and gender composition of its directors, director nominees and executive officers. The bills would also require companies to disclose whether the board or any committee has adopted a policy, plan or strategy to promote racial, ethnic and gender diversity among the board, director nominees or executive officers. At the time of writing this report, neither bill had yet been passed.

In determining a company's commitment to gender diversity on the board, ISS also takes into account a board's disclosed approach to considering gender diversity in executive officer positions and its stated goals or targets or its programs and processes for advancing women in executive officer roles, and how the success of those programs and processes is monitored.

CCGG is of the view that as a matter of best practice, gender diversity policies should incorporate targets for women on the board. CCGG also recommends having a method for measuring progress against the target, including a timeline for achieving the target.[139] Also, according to CCGG, while a company's target should not be prescribed by regulators at this time, a company's choice of target should be informed by relevant research and with the intention of increasing gender diversity. CCGG recommends that "in setting an appropriate target, boards should give due consideration to research that supports the adoption of at least a 30% target on the basis that this level constitutes a 'critical mass' whereby the views of the diverse members of a group are viewed not through a prism of tokenism but carry the same weight as the opinions of other group members."

5 **Disclose the number and proportion (in percentage terms) of women on the board and in executive officer positions. For the figures for executive officers, include all major subsidiaries.**

This disclosure is required by NI 58-101, the *TSX Company Manual* and the CBCA Amendments. Another measure that issuers should consider, although it is not currently mandated, is disclosure of their progress in increasing the number of women on boards and in executive positions: for example, by showing year-over-year improvements in their metrics and providing a discussion of the key actions taken by the company that contributed to (and are expected to continue contributing to) the increase in female representation.

6 **Disclose whether your company has adopted term limits for the directors on the board or other mechanisms of board renewal, and, if so, include a description of those term limits or mechanisms of board renewal. If your company has *not* adopted these measures, disclose why it has not done so.**

This disclosure is required by NI 58-101, the *TSX Company Manual* and the CBCA Amendments.

CCGG recommends that "in setting an appropriate target, boards should give due consideration to research that supports the adoption of at least a 30% target on the basis that this level constitutes a 'critical mass' whereby the views of the diverse members of a group are viewed not through a prism of tokenism but carry the same weight as the opinions of other group members."

Glass Lewis strongly supports routine director evaluation, including independent external reviews and periodic board refreshment. Glass Lewis recommends that boards evaluate the need for changes to their composition based on an analysis of skills and experience necessary for their companies, as well as the results of the director evaluations – as opposed to relying solely on age or tenure limits. On occasion, age or term limits can be used as a means to remove directors from boards that are unwilling or unable to police their membership and enforce turnover. Where a board that has adopted age or term limits waives those limits, Glass Lewis will consider recommending that shareholders vote against the nominating and/or governance committee, unless the limits were waived with sufficient explanation, such as consummation of a corporate transaction.[140]

CCGG also recommends setting director term limits and/or a retirement age to help increase the percentage of women on boards.

See Chapter 5, In Focus: Building High-Performing Boards, for additional information about how to build high-performing boards, including when selecting new director nominees.

THE GLOBE AND MAIL'S 2018 BOARD GAMES DIVERSITY CHEAT SHEET

Consideration of the Representation of Women on Boards and Senior Management

- *Two* marks were awarded to a company that disclosed details of its diversity policy for the consideration of the representation of women on its board and senior management and included an internal target for the proportion of women on the board with specifics of the target details and a timeline for achieving the target.
- *One* mark was awarded if a company disclosed details of a process used to consider the representation of women on the board, such as recruitment practices aimed at ensuring female candidates are considered for board seats, but did not have a target or did not disclose a timeline for achieving a target (if a company had already met its target, then a timeline did not have to be disclosed).
- *Zero* marks were awarded if a company did not have a diversity policy or did not describe specific steps it took to ensure gender diversity was reflected in recruitment. That means zero marks if a policy mentions several types of diversity without disclosing any specific measures related to improving gender diversity.

Representation of Women on Boards

- *Three* marks were awarded if at least 33% of a company's directors were women.
- *Two* marks were awarded if 25% to 33% of a company's directors were women.
- *One* mark was awarded if there was at least one woman on the company's board.
- *Zero* marks were awarded if there were no women on the company's board.

If a company's board was made up of at least 50% women, a company received two marks even if it did not adopt a formal diversity target.

Spotlight: Shareholder Proposals and Guidelines on Diversity Going Strong

Institutional investors and pension funds in Canada and abroad continue to incorporate diversity-related guidelines into their voting decisions, and in 2019, for the first time in Canada, investors voted in favour of a shareholder proposal on gender diversity.

Below are some examples of diversity-related proposals and policies adopted by leading Canadian investors. Boards should ensure they understand their investor base and remain responsive to shareholders' expectations and evolving voting guidelines.

- For the first time in Canada, investors voted in favour of a shareholder proposal on gender diversity. At TSX-listed Waste Connections, Inc.'s 2019 annual meeting, its shareholders voted 64.49% in favour of a proposal requesting the issuer to establish a clear plan to increase the representation of women on its board, in executive officer positions and across its workforce. The proposal was made by the British Columbia Teachers Federation.[141]
- As of 2019, Ontario Teachers' Pension Plan will consider not supporting the chair of the governance and/or nomination committee or other members of the committee in situations where Teachers' concludes that there is insufficient representation of female directors and the board does not adequately describe its approach to gender diversity.[142]
- As of 2019, BMO Global Asset Management declared that it would continue to use its voting power to drive change at the board level. It will not support the election of nomination committee chairs or other relevant directors on boards without requisite female representation and where there is unwillingness to fully address the issue.[143]
- As of February 2019, if a company's board has fewer than two female directors, RBC Global Asset Management will vote against directors who sit on the nominating or corporate governance committee.[144]

– Canada Pension Plan Investment Board has established a policy to vote against the chair of the board committee responsible for director nominations at its investee public companies if a company's board has no female directors as of December 31, 2018.[145]

– As of April 2, 2018, OMERS will consider withholding its vote from the chair of the nominating committee if a company has no female directors and insufficient policies, such as a lack of specific goals or targets, in place to increase the number of women on its board and at the executive level.[146]

– As of October 2018, Alberta Investment Management Corporation may vote against or withhold its vote from the chair and/or members of the nominating committee or another relevant board director where the issuer exhibits low levels of board gender diversity. Examples are companies with less than 20% female directors, with no stated commitments to achieve gender diversity and/or with no improvement in their board gender diversity year over year.[147]

– British Columbia Investment Management Corporation (bcIMC) provided comments to the OSC on May 28, 2018, recommending that the OSC require issuers to have a formal written diversity policy in place that articulates a specific target for women. bcIMC suggests a target of 30% by 2022.[148] As of 2018, bcIMC will vote against chairs of nominating committees at companies where there are less than 25% female directors and where the board does not provide any explanations or plans to address the issue.[149]

– Healthcare of Ontario Pension Plan will vote against or withhold its vote from the chair of the nominating committee or the entire nominating committee where a board has fewer than two female directors, unless the board has a robust public policy on gender diversity or a robust public policy on board renewal that addresses gender diversity.[150]

– OPTrust will vote against the chair of the nominating/governance committee if a company has less than 30% women on the board and either does not disclose its policy on diversity or has a policy that does not outline the company's plan to achieve that target in a reasonable period of time.[151]

Our Take:
Five Practical Tips to Help Move the Diversity Needle

1 What gets measured gets done. Consider adopting a target.

The 2018 CSA Review and our review of issuers on the Composite and SmallCap indices both support the business case for adopting targets for the representation of women: issuers that had adopted board targets had an average of 27% of their board seats held by women, compared with issuers without targets, which had an average of 21%.

"Before we start looking at quotas, I'd like us to focus on targets. What gets measured gets done, but we don't actually say what we're going to achieve. We say it about sales targets or earnings-per-share growth – how about measuring the most important asset, which is people? Some say targets are the same as quotas. They're not. Quotas are rules. Targets are aspirational. We set reasonable milestones to get there. Look at the 30% Club and the impact it has had overseas. When the idea took hold, everyone moved toward it. It gives everybody a road map."[152]

2 Consider whether to expand your board size.

Board turnover continues to be slow. We have heard the views of many expressed over the years, advocating for age and term limits to facilitate board turnover; others, however, are advocating that issuers expand their board sizes to improve diversity. While increasing board size may be appropriate for some issuers, companies should not increase their board size solely for the purposes of enhancing diversity if doing so will not enhance (or could compromise) the composition and effectiveness of their board.

"In the S&P 500 overall, more than half of the new women joining boards in 2018 came on when the board increased its size [...] When TripAdvisor added two female directors [...] it contributed to this trend, boosting its board from eight directors to ten."[153]

3 Consider more diverse board criteria.

As companies look to diversify their boardrooms, the criteria for candidates need to be carefully considered and more flexible, with less rigid focus on all candidates having C-suite experience. Otherwise, the shift in female representation on boards will continue to be contingent on a corresponding improvement in the representation of women in executive officer positions.

"The lack of women in senior leadership positions is a key reason for the shortage of female directors. To be on a board, you need to have exposure at a senior corporate level, and when you look at statistics on women in leadership, it's disheartening. Many boards are looking for people with financial expertise who can chair an audit committee, and you need to have been a CFO at a company of similar size and complexity. Not many women have been in such a role, and those who have are in such great demand that they often have to say no. The pipeline is not as robust as it could be.[154]

4 Look at your culture. Ensure your culture supports diversity and inclusiveness.

The Equileap 2018 Report underscores this point: beyond the representation of women, there are a number of other factors that impact whether a company's culture encourages gender equality more broadly.

"A gender-diversity strategy isn't just about hiring more women. It's about creating the kind of organization that women will want to join and where they'll want to remain because they know it will afford them the opportunity to grow and contribute and eventually lead and govern.[155]

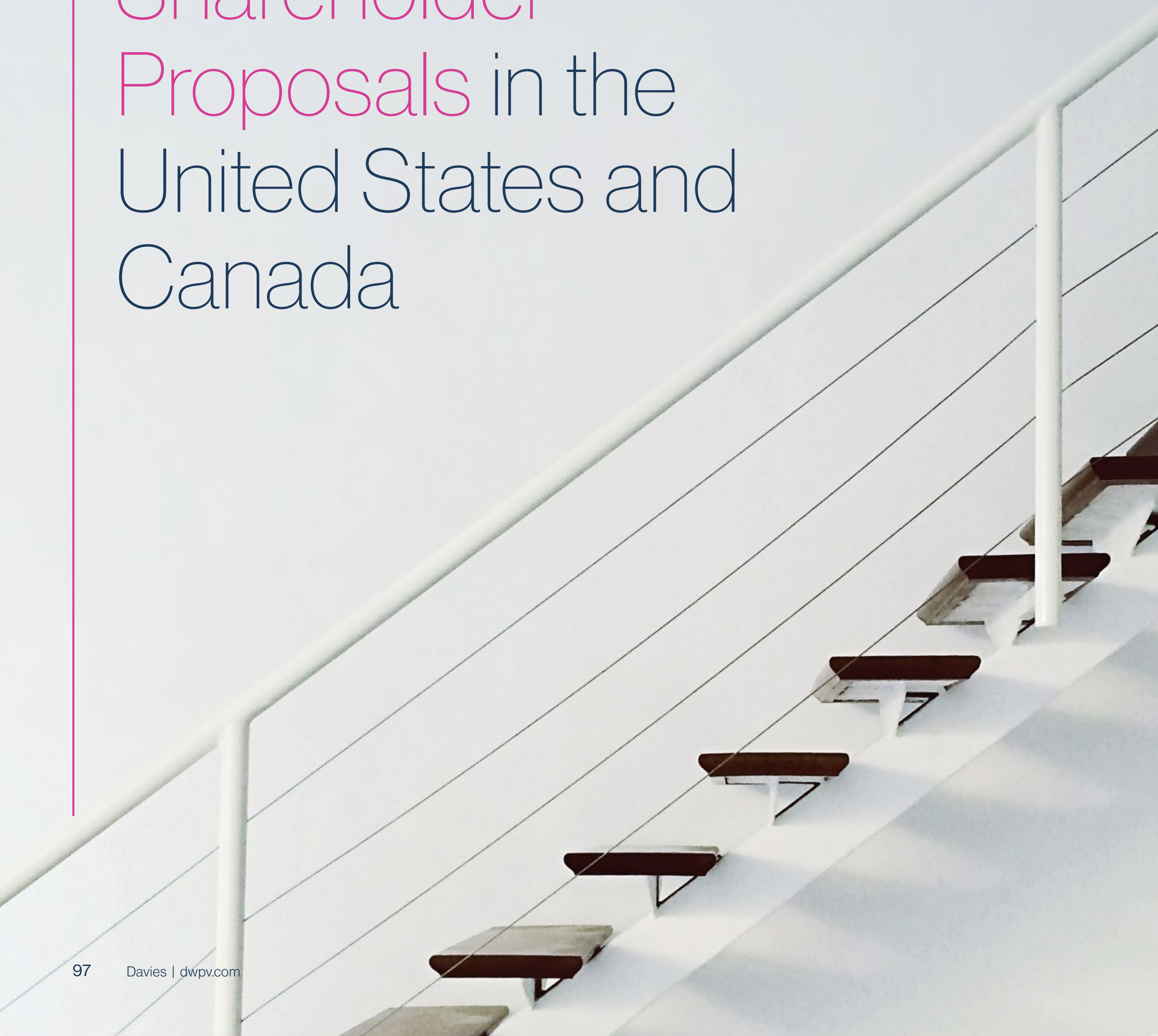
5 Move past the business case approach. It's time to execute.

The business case for diversity in the boardroom and among executives has been made time and time again over the past several years. It's time to move past focusing on, or debating, the business case to the more difficult question of how to take steps within your organization to ensure gender diversity is being prioritized on the same agenda as other high-priority business items.

"We recognize the work financial institutions are doing to move from 'why' they should advance women in the economy to 'how' they can advance women in the economy. The business case has been made – it's time to execute."[156]

CHAPTER 07

Shareholder Proposals in the United States and Canada



Shareholder proposals have long been an effective tool for investors to raise environmental, social and governance issues and foster engagement with a public company. That said, compliance with the shareholder proposal regime can impose costs and burdens on companies. For years, the U.S. Securities and Exchange Commission (SEC) has been trying to balance the benefits and costs of shareholder proposals. A bill proposed in 2018 and statements from the SEC Chairman indicate that the SEC will propose revisions to the shareholder proposal regime in the near future, especially with respect to the requirements for resubmitting proposals that were previously rejected by shareholders. In this chapter, we review the existing shareholder proposal regime in the United States and discuss potential changes to the resubmission thresholds. We also take a look at the rising number of shareholder proposals in Canada, a regime not likely to change in the near future.

Existing U.S. Shareholder Proposal Regime

The shareholder proposal regime in the United States, governed by rule 14a-8 under the *Securities Exchange Act of 1934*, gives shareholders an opportunity to recommend or require that a company and/or its board of directors take a specific action, often relating to environmental, social and governance (ESG) issues. Proponents of shareholder proposals include activist investors, public pension funds, hedge funds and special interest groups. For years, the U.S. Securities and Exchange Commission (SEC) has been trying to balance the benefits of the rule and the scope of its application with the resulting burdens and costs associated with compliance. We expect the SEC will propose revisions to the rule in the near future, particularly as they relate to the thresholds for resubmitting previously defeated proposals.

Under the current rule, an eligible shareholder that satisfies certain requirements may submit a proposal to be voted on at a company's upcoming shareholders' meeting. To submit a proposal, a shareholder must have continuously held at least US$2,000 in market value, or 1%, of the company's voting securities for at least one year before submitting the proposal and must continue to hold those securities through the meeting date. The shareholder or its representative must attend the meeting to present the proposal. Unless the proposal is excluded on certain procedural or substantive grounds enumerated in the rule, the company must include the proposal in its proxy materials for the applicable shareholders' meeting.

A company may exclude a proposal from its proxy materials on 13 substantive grounds enumerated in rule 14a-8, including if the proposal:

- does not present a proper subject for action by shareholders under the laws of the company's jurisdiction of organization;
- would, if implemented, cause the company to violate any applicable state, federal or foreign law;
- relates to a personal claim or grievance against the company or any other person, or is designed to result in a personal benefit or further a personal interest not shared by other shareholders at large;
- relates to operations that account for less than 5% of the company's total assets at the end of its most recently completed fiscal year and for less than 5% of its net earnings and gross sales for such year, and is not otherwise significantly related to the company's business; or
- deals with a matter relating to the company's ordinary business operations (which should be addressed by the board of directors, not by the shareholders).

A company that intends to exclude a proposal from its proxy materials must file its reasons (together with any supporting materials) with the SEC. The SEC staff is responsible for deciding which proposals may be excluded, until recently, through the issuance of no-action letters. On September 6, 2019, the SEC staff announced that it is changing its process for administering rule 14a-8. In cases where a company seeks to exclude a proposal, the SEC staff will inform the proponent and the issuer of its position, which may be that staff concurs, disagrees with or declines to state a view, with respect to the company's asserted basis for exclusion.[157] Starting with the 2019 to 2020 proxy season, the SEC staff may also respond orally instead of in writing to some no-action requests. The SEC staff intends to issue a response letter where it believes doing so would provide value, such as more broadly applicable guidance about complying with rule 14a-8.

An issuer may also exclude certain shareholder proposals dealing with substantially the same subject matter that had been voted on in recent years. Specifically, an issuer may exclude a resubmitted proposal if in the preceding five years the proposal:

– was voted on once and received less than 3% of the votes cast;

– was voted on twice and received less than 6% of the votes cast the last time it was voted on; or

– was voted on three or more times and received less than 10% of the votes cast the last time it was voted on.[158]

The existing minimum percentage thresholds for resubmitted proposals were established in the 1950s. Until institutional investors became more active participants in shareholder voting, these thresholds prevented the majority of proposals from winning sufficient support for resubmission. In recent years, with institutional investors becoming more active participants in shareholder voting, the vast majority of shareholder proposals now receive the required minimum percentage of the vote and are therefore eligible for resubmission. In fact, research published by the CII Research and Education Fund in 2018 concluded that at least 90% of failed shareholder proposals would be eligible to be resubmitted under the current regulatory regime.[159]

Research published by the CII Research and Education Fund in 2018 concluded that at least 90% of failed shareholder proposals would be eligible to be resubmitted under the current U.S. regulatory regime.

Proposed Changes to U.S. Proposals: Raising the Resubmission Thresholds

On May 10, 2018, Representative Sean Duffy introduced a bill (H.R. 5756) to direct the SEC to revise rule 14a-8(c)(12) to raise the minimum percentage thresholds for resubmitting a shareholder proposal from 3%, 6% and 10% to 6%, 15% and 30%, respectively.[160] The U.S. House of Representatives Committee on Financial Services stated that the objective of raising the resubmission thresholds, as proposed in H.R. 5756, was to reduce the burdensome costs borne by companies in connection with shareholder proposals and enable companies to focus their resources on getting the greatest returns for their shareholders.[161] The committee argued that, due to the extremely low bar for qualification to submit a proposal, as well as the SEC's increasing tendency to err on the side of the shareholders, special interest activists were taking advantage of the current regulatory regime to advance their social, environmental or political agendas at the expense of other shareholders. The cost of a proposal, according to the committee, could run up to US$150,000 per proposal, with some companies facing 15 or more a year, equating in such instances to US$2 million in time and resources that were purportedly being diverted from the core fiduciary responsibility to maximize shareholder value. The CII Research and Education Fund estimated that, if adopted, the higher proposed resubmission percentages would triple the number of proposals that would be ineligible for resubmission under the current U.S. rule.[162]

The minority view of the committee members who opposed H.R. 5756 argued that the bill was "premised on the misconception that shareholders are abusing the shareholder proposal process to promote activist interests to the detriment of public companies. To the contrary, shareholder proposals have benefited public companies in terms of increased shareholder engagement and improved performance." They cited, for example, improving gender diversity on corporate boards, which has enhanced board decision-making. According to one committee member, such progress in diversity would not have occurred had the resubmission thresholds been enacted during the early stages of board diversity proposals. On this basis, the minority view of the committee was that higher submission thresholds would defeat many important shareholder proposals on the environment, diversity, corporate governance and other critical issues.[163] It is also important to bear in mind that the majority of companies never face any proposals, with the average number of proposals faced by issuers being typically very low (fewer than two).

TABLE 7-1:
U.S. Shareholder Proposal Regime: Existing Rule and Potential Amendments

Eligibility Requirements	Existing 14a-8 Requirements	Potential Amendments
Ownership thresholds	Shareholder must have continuously held at least US$2,000 in market value, or 1%, of the company's securities entitled to be voted on the proposal at the meeting for at least one year before submitting the proposal. Shareholder must hold the securities through the date of the meeting and agree to present (or have a qualified representative present) the proposal at the meeting.	Unknown.
Resubmission thresholds	If the proposal deals with substantially the same subject matter as another proposal that has been previously included in the company's proxy materials within the preceding five years, the new proposal may be excluded from proxy materials for any shareholders' meeting held within three years of the last submission if the proposal received: – less than 3% of the vote if proposed *once* within the preceding five years; – less than 6% of the vote on its last submission to shareholders if proposed *twice* previously within the preceding five years; or – less than 10% of the vote on its last submission to shareholders if proposed *three* times or more previously within the preceding five years.	If the proposal deals with substantially the same subject matter as another proposal that has been previously included in the company's proxy materials within the preceding five years, the new proposal may be excluded from proxy materials for any shareholder meeting held within three years of the last submission if the proposal received: – less than 6% of the vote if proposed *once* within the preceding five years; – less than 15% of the vote on its last submission to shareholders if proposed *twice* previously within the preceding five years; or – less than 30% of the vote on its last submission to shareholders if proposed *three* times or more previously within the preceding five years.

What's Next in the United States? SEC Likely to Propose Changes

In a speech outlining the SEC's agenda for 2019, SEC Chairman Jay Clayton suggested that the SEC consider reviewing the ownership and resubmission thresholds for shareholder proposals under the rule, including whether there are factors, in addition to the amount invested and the length of time shares are held, that reasonably demonstrate that the proposing shareholder's interests are aligned with the company's long-term investors.[164] Similarly, in the SEC's semi-annual regulatory agenda published on May 22, 2019, the SEC's Division of Corporation Finance indicated that it is considering recommending that the SEC propose amendments to the thresholds for shareholder proposals under rule 14a-8.

Although the SEC has yet to propose any specific amendments to the rule, it is widely expected that amendments will be proposed in the coming months.

Canadian Shareholder Proposal Regime

Similar to the United States, shareholders of Canadian corporations can avail themselves of the shareholder proposal regimes under Canada's applicable federal or provincial corporate statutes to raise ESG issues and to submit nominations for the election of directors, albeit rarely used for the latter purpose. For example, under Canada's federal corporate statute – the *Canada Business Corporations Act* (CBCA) – to be eligible to submit a shareholder proposal, the shareholder must hold voting shares equal to at least 1% of the outstanding voting shares or with a fair market value of at least $2,000 through the date of the applicable shareholders' meeting.[165] If the proposal involves the nomination of one or more directors, it must also be signed by one or more shareholders representing in the aggregate at least 5% of the shares entitled to vote at the meeting (and, in that case, there is no limit on the number of nominees that may be submitted by proposal).[166] A corporation that receives an eligible proposal is required to include it in its management proxy circular for the shareholders' meeting.

Under the CBCA, a corporation can reject a proposal and exclude it from its proxy circular on the basis of certain specified procedural or substantive grounds, some of which are similar to those under existing U.S. rule 14a-8. One such basis for excluding a proposal is when substantially the same proposal was submitted to shareholders in the corporation's proxy circular or in a dissident proxy circular relating to a shareholders' meeting held not more than a prescribed period before the receipt of the proposal and the proposal did not receive the prescribed minimum amount of support at the meeting.[167] For these purposes, the prescribed period and the prescribed minimum amounts of support for being eligible to resubmit a previously submitted proposal under the CBCA generally correspond to those under existing U.S. rule 14a-8 – namely, within five years and with support thresholds of 3%, 6% and 10% of the total number of shares voted.[168]

Unlike the U.S. proposal regime, however, Canada's securities regulators do not oversee (or issue no-action letters or advice to public companies) with respect to proposals that issuers reject. Rather, the issuer's board would determine whether or not to accept or reject a proposal, and a shareholder claiming to be aggrieved by a corporation's refusal to include a proposal in a proxy circular only has recourse to the Canadian courts.

Shareholder Proposals in Canada on the Rise

Following a three-year downward trend, 2019 witnessed a resurgence in shareholder proposal activity in Canada. As Table 7-2 demonstrates, this year an aggregate of 62 proposals were put forward to 30 Canadian issuers on the Composite and SmallCap indices, in line with the high levels witnessed in 2015.

TABLE 7-2:
Shareholder Proposals at Issuers on the TSX Composite and SmallCap Indices (2015–2019)

	2019	2018	2017	2016	2015
Number of proposals	62	37	46	47	65
Number of issuers receiving proposals	30	22	22	24	26
Number of financial institutions receiving proposals	7	4	7	7	7
Average percentage of votes cast "for" (all proposals)	13%	16%	18%	14%	19%
Average percentage of votes cast "for" (excluding proposals approved by shareholders)	12%	10%	12%	7%	11%

In Canada, the most common topics subject to shareholder proposals in 2019 included the following:

- requiring an advisory say-on-pay vote on executive compensation, integrating ESG criteria and sexual misconduct measures into executive compensation, disclosing equity ratios used to set compensation and reviewing relative compensation inequality;
- climate change–related proposals, such as requiring setting and publishing greenhouse gas emissions-reduction targets, producing an annual sustainability report, disclosing measures supporting the transition to a low-carbon economy and reporting on sustainable packaging, deforestation and the social impacts of food waste;
- creating a new technology committee;
- social issues, such as minimum requirements for workforce practices, Indigenous people's rights, human rights policies and the adoption of a living wage policy;
- adopting a policy on the representation of women on the board and within senior management;
- requiring separate disclosure of voting results by classes of shares and related disclosures; and
- director independence issues.

Of the 62 proposals put forward to Canadian issuers in our sample study, in 2019 only one received majority shareholder approval: a proposal to Waste Connections, Inc., to adopt a policy on board diversity (also discussed in Chapter 6, Navigating Gender Diversity in 2019). Shareholder support for the remaining shareholder proposals that did not achieve majority approval was consistent with the five-year average at 12%.

Our Take: Eligibility for Making Shareholder Proposals May Change in the United States

As discussed in several previous Davies Governance Insights reports, including *Davies Governance Insights 2018*,[169] shareholders of Canadian and U.S. companies have long had the ability to use the shareholder proposal regime to raise concerns regarding the companies in which they invest. Proposals can be an effective tool, not only for raising proposals or issues at a shareholders' meeting, but also for encouraging engagement between companies and investors on topics of potential importance. In fact, proposals are often withdrawn by shareholders and never presented at shareholders' meetings when meaningful engagement between the issuer and the submitting shareholder has occurred. In Canada, there appear to be no plans or appetite for making the shareholder proposal regime any more onerous to shareholders, viewing it as a fundamental element of facilitating shareholder democracy. And while the U.S. shareholder proposal regime may face changes in the future that could make it more onerous for some shareholders to utilize, boards should remain aware that activism and engagement, including by historically more passive institutional investors, is now relatively mainstream. Consequently, boards and senior management should engage with, listen to and strive to be responsive to the reasonable demands or requests of their owners.

CHAPTER 08

Innovative Tools for Convenient and Transparent Disclosure and Effective Engagement

Market participants are increasingly calling on public companies to provide more transparent and convenient information. In this chapter, we explore how Canadian public companies can meet these expectations by making their communication (including and beyond traditional continuous disclosure documents) and engagement practices both clearer and more user-friendly. Through our review of all TSX 60 issuers' corporate websites, we identify principal barriers to having a user-friendly and effective website, and provide practical tools to optimize usability and stakeholder engagement. More generally, we discuss how leveraging a company website, making use of notice-and-access, hosting hybrid-virtual meetings and making (appropriate) use of social media outlets all provide enhanced opportunities for a company to more effectively convey its strategy and business plans, and foster long-term viability.

Communication and Engagement: Building Transparency and Convenience

With sustained levels of shareholder activism and engagement, as well as increased attention on environmental, social and governance (ESG) issues, the stakes for boards and senior management to deliver clear disclosure and effective engagement are higher than ever. Broadly speaking, disclosure to shareholders consists of disseminating information about a corporation to the public, whereas engagement involves a corporation's communication with its shareholders (and, more broadly, stakeholders) and vice versa. Rethinking traditional modes of disclosure and engagement is imperative for most directors and senior management in order to satisfy both their stakeholders' desire for convenient and transparent information and their duties to act in the best interests of the corporation.

Canadian public companies' disclosure practices and engagement strategies have traditionally focused on fulfilling prescribed continuous disclosure requirements and shareholders' participation in analyst conference calls, quarterly earnings calls and annual shareholders' meetings. Reporting issuers have always been required to prepare, file and disseminate written disclosure materials with respect to their business, operations and financial results. With seemingly ever more demanding disclosure best practices and obligations, these materials are now often complex, lengthy, duplicative and difficult to consume. And annual shareholders' meetings and earnings calls are often carefully scripted, perfunctory and poorly attended events. Market participants are increasingly pressing for more transparent and convenient communication, as recently stressed by BlackRock Chairman and CEO Larry Fink and the U.S. Business Roundtable.[170]

How can corporations transform their communication and engagement practices to be both transparent and convenient? In our view, disclosure and engagement must evolve from a process too often undertaken solely to comply with securities regulatory obligations into a strategic priority that integrates diverse stakeholder feedback and input, thus allowing a board to fulfill its fiduciary oversight responsibility.

Creating Effective Website Disclosure

Where SEDAR was once the first stop for capital market participants seeking access to company information, corporate websites are now the de facto source of information for investors and market participants. Projecting a strong public-facing presence should therefore start with maintaining a website that clearly broadcasts timely and relevant company information. If done right, a corporate website can be an effective and critical tool to increase and optimize stakeholder (and not just shareholder) engagement by communicating the corporation's vision, strategy and activities.

In our view, disclosure and engagement must evolve from a process too often undertaken solely to comply with securities regulatory obligations into a strategic priority that integrates diverse stakeholder feedback and input, thus allowing a board to fulfill its fiduciary oversight responsibility.

STOCK EXCHANGE WEBSITE DISCLOSURE REQUIREMENTS

As a baseline, issuers' websites should meet the applicable legal requirements. Currently, Canadian corporate statutes do not prescribe what public companies should post on their corporate websites. However, the Toronto Stock Exchange (TSX) imposes the following website disclosure requirements on listed issuers (subject to certain categories of excluded issuers):

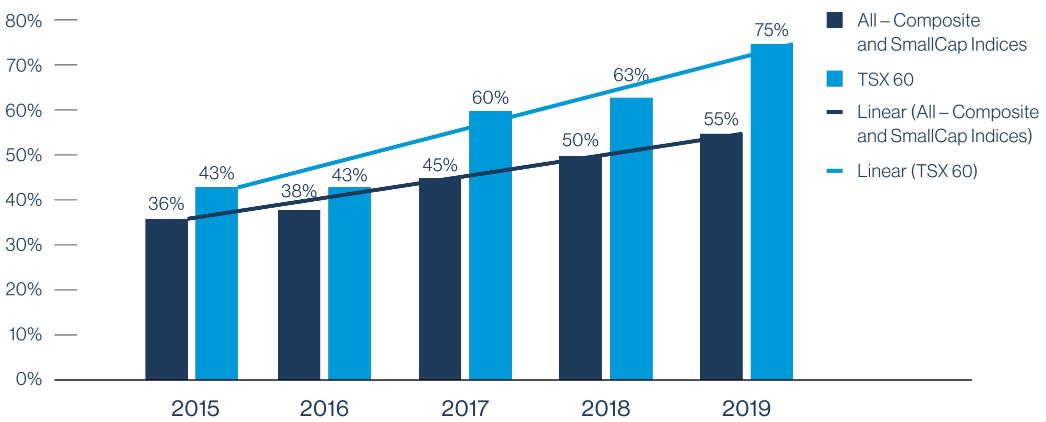
TABLE 8-1:
TSX and TSXV Disclosure Requirements

Issuer Type	Disclosure Requirements
TSX-listed issuers' basic requirements	Maintain a publicly accessible website and post the current, effective versions of the following documents (or their equivalent):[171] a) articles or any other constating documents and all bylaws of the issuer; b) if adopted/applicable, copies of the – majority voting policy;[172] – advance notice policy/bylaw; – position descriptions for the board chair and/or lead director; – board mandate; and – board committee charters.
TSX-listed issuers engaged in mineral exploration, development and production	Must also ensure that:[173] a) a website address is provided in all corporate disclosure documents; – any disclosure should be posted on the website immediately after it has been otherwise published; and – the information should remain posted "until such time as the company has disclosed that it has discontinued work on a property, or no longer has any interest in the property, or the information has been superseded by disclosure of further work on the property;" and b) any information required to be disclosed under National Instrument 43-101 – *Standards of Disclosure for Mineral Projects* is readily obtainable from the company by email, fax or mail, or through a website.
TSX Venture Exchange (TSXV)-listed issuers' basic requirements	No requirements equivalent to those of TSX-listed issuers.
TSXV-listed issuers engaged in mining	Must ensure that:[174] a) all geological reports referred to in a news release or as part of a TSXV filing are available from the issuer or posted on the issuer's website; and b) the disclosure of the company's mineral properties on its website complies with certain requirements, including being up to date and containing the names of qualified persons responsible for preparing scientific and technical information.

In addition, where a company uses the notice-and-access regime for delivery of proxy-related materials to shareholders, Canadian securities laws require the issuer to post the meeting materials and the notice and form of proxy on SEDAR and another website (which could be the issuer's website) at least 30 days prior to the meeting. Notably, as shown in Figure 8-1 below, in 2019, 75% of companies on the TSX 60 (up from 43% in 2015), and 55% of the Composite Index and SmallCap Index issuers (up from 36% in 2015) now use notice-and-access. And we expect these numbers will continue to rise with the recent amendments to the *Canada Business Corporations Act* (CBCA), which will now allow public companies existing under the CBCA to use the increasingly popular notice-and-access regime.

In 2019, 75% of companies on the TSX 60 (up from 43% in 2015), and 55% of the Composite Index and SmallCap Index issuers (up from 36% in 2015) now use notice-and-access.

FIGURE 8-1:
Percentage of Issuers on the TSX Composite and SmallCap Indices that Use Notice-and-Access (2015–2019)



ADDITIONAL GUIDANCE ON WEBSITE DISCLOSURE

Of the various regulators in Canada, only the TSX and the Canadian Securities Administrators (CSA) offer practical tips for companies concerning the maintenance of an effective investor relations (IR) website. As shown in Figure 8-2, the TSX and CSA recommend that listed issuers do the following, among other things:[175]

FIGURE 8-2:
Overview of TSX's and CSA's Recommendations for an Effective Website

Post Information

- Make available all "timely disclosure" documents and other IR information.
- Post IR information as soon as possible following dissemination.
- Post IR contact information.
- Concurrently post on the company's website all documents filed on SEDAR.
- Separate promotional and investor information.
- Remove outdated or inaccurate information.

Safeguard the Website

- Have a clear written policy on electronic communications.
- Regularly review and monitor the website's integrity.
- Avoid deep-linking (i.e., linking to a webpage that is not a homepage).
- Avoid posting media articles.
- Ensure all third-party links are accompanied by a disclaimer that the viewer is leaving the company's website and that the company is not responsible for the content, accuracy or timeliness of other sites.

Practise Knowledge Management

- Maintain email distribution lists with subscription capabilities or automated software to provide updates to issuers (dissemination of information via a newswire service must occur first).
- Establish an archiving system.
- Date documents and maintain logs of material information that have been posted and removed from the website.

Monitor Employee Conduct

- Prohibit employees from participating in Internet chat rooms, newsgroups or social media in discussions relating to the issuer or its securities.
- Require employees to report any online discussion pertaining to the issuer.

SHAREHOLDER ENGAGEMENT POLICIES

Many of Canada's largest public companies have already adopted formal engagement policies; for those that have not, institutional investors, asset managers and corporate governance watchdogs continue to advocate for more active, ongoing and collaborative engagement with non-executive directors. A formal policy or framework setting out the board's approach to shareholder engagement, including whether, when and how the board will engage can:

- Provide guidance on which topics will properly be addressed by the board versus those that will be referred to management.
- Open up a direct dialogue between directors and shareholders.
- Create a forum to gain investors' views on corporate strategies, risk management, ESG topics and executive performance and compensation.

When creating a policy:

- Remember that the board's engagement efforts are intended to complement and not displace the CEO, management and investor relations' primary responsibilities in this area.
- Include a copy of the policy separately on the website instead of burying it in the annual report or information circular.

If you don't have a policy:

- Consider developing a framework for engagement, to set the parameters for when, if and how to engage with investors both during business as usual and in the case of a crisis.

DISCLOSURE RULES APPLY TO ELECTRONIC COMMUNICATIONS

Information posted on a corporate website is subject to the same securities laws as information contained in traditional disclosure documents. Typically, disclosure of information through an issuer's website alone is insufficient to satisfy its disclosure obligations under securities laws. In addition, the following requirements apply:

- Electronic communications must not be misleading.
- Issuers have a duty to correct and update websites.
- Information must be presented in a consistent manner.
- Electronic communications must not be used to "tip" or leak material information.
- Special attention should be given to applicable foreign securities laws.

Ultimately, a standard of timely, up-to-date-and accurate information is the best practice.

Thus far, Canadian corporate governance commentators have published few website disclosure guidelines, despite the central role played by company websites in disseminating information and communicating with market participants. Of the two main proxy advisory firms, only Glass Lewis & Co. references a company's website, stating that it considers a company's website when evaluating board responsiveness.

Case Study: TSX 60 Website Practices

In June 2019, we conducted a review of all TSX 60 issuers' corporate websites. The review focused on assessing compliance with the TSX's rules and identifying the factors that make a website more or less effective. The quality of websites surveyed varied, with some being significantly more informative and user-friendly than others. Generally speaking, many of the websites revealed opportunities for improvement. We note that some documents that we treated as being "unavailable" in our review may in fact be available but were so difficult to locate on the website that the average user would be unlikely to easily find or access them. At a high level, the results of our review are shown in Table 8-2 below.

TABLE 8-2:
TSX 60 Issuers' Compliance with TSX Website Disclosure Rules (2019)

Prescribed Policy/Document(s)	Compliance
Articles and other constating documents and bylaws	92%
Majority voting policy	90%
Advance notice policy	Approximately 95%*
Position descriptions for the board chair and/or lead director	73%
Board mandate	92%
Board committee charters	98%

* Approximate compliance rate, based on the number of TSX 60 issuers that disclosed having an advance notice bylaw or policy and whether the document was available on the website.

BARRIERS TO A USER-FRIENDLY WEBSITE

From our review, we identified the following principal barriers to having a user-friendly and effective website:

– **Deep-linking.** Users had to click through multiple webpages and links to access corporate governance materials.

– **Materials spread across webpages.** Corporate governance materials were not listed and linked on a single webpage; instead, they were spread across multiple webpages.

– **Materials buried in annual reports or information circulars.** Governance materials were buried within larger annual reports and information circulars on the website, rather than being linked as separate documents.

– **Ineffective search toolbar.** Some websites had ineffective or poorly functioning search toolbars.

– **Failure to include optical character recognition (OCR).** Documents were linked only as images, and OCR was not available, so terms were not searchable.

– **Undated documents.** Documents were linked but undated, creating uncertainty whether the posted documents were current and accurate.

– **Multiple documents in a single PDF file.** Some companies combined several required documents within a single PDF file, rendering it difficult, for example, to find a majority voting policy within a broader set of governance policies or principles unless the user opened and reviewed the entire document.

TOOLS TO OPTIMIZE USABILITY

On the other hand, some websites reviewed were very effective and employed leading-edge techniques to improve their usability and clarity, including the following recommended tools:

– **Contact information.** Provide key contact details such as email addresses, phone numbers, office location(s) and hours.

– **Clearly labelled and visible links.** Include a direct link to a governance webpage containing all required documents, clearly labelled and hyperlinked to PDF files. While many companies have their advance notice requirements within their bylaws, indicating this in parentheses beside the bylaws makes them readily accessible.

– **Enabled search functions.** Equip websites with user-friendly search engines that search not only titles but also entire documents for keywords. The most user-friendly way of displaying search results is to sort them either by relevancy to the search terms or in chronological order. Having an advanced search function that filters results by date, topic, individual, type or document format is the most helpful.

– **Governance documents posted to the IR webpage.** Beyond meeting the TSX-mandated disclosure requirements described above, a number of companies post their codes of conduct, whistleblower policies, shareholder engagement policies and other corporate governance guidelines developed by the company.

– **Visual and audio tools.** Communicating complex information is shifting from traditional presentations and reports to more visual formats such as pictures, infographics and videos. Websites displaying pictures of the issuer's directors, executives and committee members provide a more intimate experience. Creating and maintaining an IR calendar also provides a more transparent and convenient way for investors and other market participants to track company information. Videos showcasing executives and employees can also humanize a company, fostering investor trust. Audio files are also useful for recording and making conference calls available.

- **Optimized mobile viewing.** With global mobile and tablet viewing having surpassed desktop viewing, consider adapting website content for mobile users. For instance, consider prioritizing events, summaries of key governance policies and practices, and video content for mobile and tablet users over downloadable documents.

- **User behaviour data.** To successfully connect with stakeholders, consider using website data analytics to monitor visitor behaviour. Key metrics to track include the number, frequency and duration of visits; which documents are downloaded; popularity of webpages; source of traffic; user location; exit rates; and indirect traffic trends. We recommend designating an individual to provide regular reports on user behaviour to management.

- **Sufficient, but not excessive, information.** While there is sometimes a deficit of information made available to shareholders, there must also be a balance to avoid information overload. Consider the profile of website users – who will mostly be investors, analysts and other key stakeholders such as employees and regulators.

Virtual and Hybrid Shareholders' Meetings

As discussed in *Davies Governance Insights 2018*,[176] one means whereby some issuers are beginning to leverage technology to engage with shareholders is through hybrid and virtual shareholder meetings. Virtual meetings can facilitate shareholder participation by enabling shareholders to view meetings, listen to discussions, ask questions and vote their shares, all through the means of secure technology and without the cost and time to attend in person.

A staggering 103 companies on the Composite Index and SmallCap Index held hybrid-virtual meetings for their 2019 annual shareholders' meetings.

There are two principal types of virtual shareholders' meetings:

- **Hybrid-virtual meetings.** These are traditional in-person 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.** These meetings cannot be attended in-person by shareholders. Accessing an online portal is the sole means available to attend, ask questions and vote at the meeting.

The only two reporting issuers established under Canadian law to have held virtual-only meetings are Concordia International Corp. (in June 2017) and Canada Goose Holdings Inc. (in both August 2018 and August 2019). Both companies implemented audiovisual streaming technology, secured attendance authentication and real-time voting tabulation.

Canadian corporations have only recently begun adopting the hybrid-virtual meeting format. However, a staggering 103 companies on the Composite Index and SmallCap Index held hybrid-virtual meetings for their 2019 annual shareholders' meetings (see Figure 8-3).

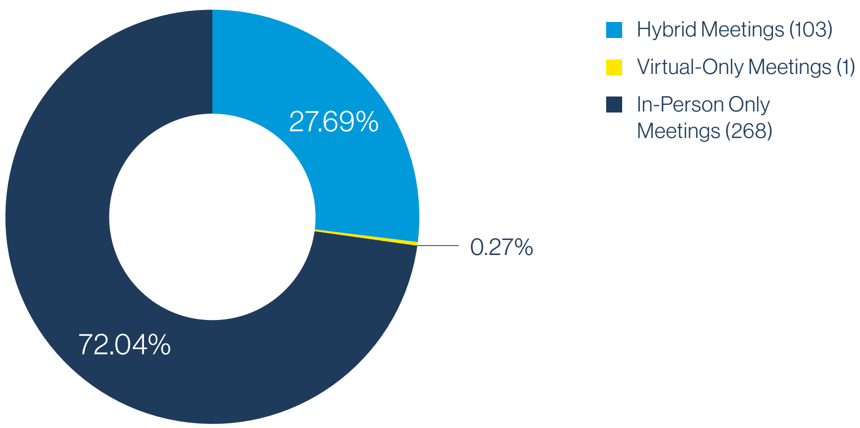
Spotlight:
Social Media as a Tool for Engagement

Social media is increasingly being used by corporations to highlight key developments or events relating to their businesses, owing to the wide audience reach, ease of accessibility and high level of public engagement. Consider whether your company's social media usage reflects the following guidance:

What and Where to Post	How to Post[177]
– Understand your audience. Different platforms call for different levels of sophistication. – Issue news releases prior to social media posting. – Ensure that announcements of material information are factual and balanced. Unfavourable news must be disclosed in the same manner as favourable news. – Avoid unnecessary details, exaggerations or promotional commentary. – Avoid hosting, linking to or participating in chat rooms or bulletin boards.	– Consider adopting a social media governance policy. – Designate an individual to supervise and approve all social media postings. – Designate an individual to review the adequacy of systems and programs. – Engage in "social listening," which involves monitoring what is being said about the company (and its peers). – Maintain adequate records when using social media websites. – Protect clients from misleading or false statements.

Although caution should be exercised when utilizing social media, this tool can be an effective means of communicating with stakeholders due to its speed, convenience and real-time feedback.

FIGURE 8-3:
Types of Shareholders' Meetings of Issuers on the TSX Composite and SmallCap Indices (Number and Percentage) (2019)



Companies holding a hybrid-virtual meeting have recorded increased shareholder participation at their annual meetings, and this is particularly helpful for shareholders who have time, geographic or economic constraints.

Use of remote meeting technology is a recent trend that is gaining increased attention in Canada. No longer does a shareholder have to travel distances or incur costs to hear from management or participate in a shareholders' meeting. Companies holding a hybrid-virtual meeting have recorded increased shareholder participation at their annual meetings,[178] and this is particularly helpful for shareholders who have time, geographic or economic constraints.

Investors, issuers and proxy advisory firms are closely examining the merits of adopting virtual-only meetings and debating whether and how they should be conducted. In the meantime, Canadian boards and senior management should consider whether the benefits of virtual-only meetings will serve to further enfranchise shareholders and improve access and engagement; if not, it may be premature to adopt a virtual-only 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 a more suitable alternative tool to provide enhanced access and opportunity for shareholders to participate in a company's shareholder meeting.

Our Take: Treat Disclosure and Engagement as Tools to Promote the Company's Strategy and Purpose

The reality in the current governance landscape is that market participants use corporate websites as their first, and often primary, source of information. To share information and engage effectively, issuers should not only ensure that their websites are meeting all legal requirements, but also continuously optimize their websites, consider using notice-and-access, evaluate whether to host hybrid-virtual meetings and make (appropriate) use of social media outlets and other tools for stakeholder disclosure and engagement.

The benefits are clear: doing so can allow companies to (i) better control the content and clarity of their messaging; (ii) gain insights from their website users through data analytics; and (iii) educate and connect with a broad base of investors and other key stakeholders on the business and vision of the company. Such tools can also aid companies seeking to showcase their broader efforts at being good corporate citizens by bridging the access-to-information gap for potential stakeholders who may be, for example, unable to attend in-person events or who do not have the same influence as large institutional investors.

CHAPTER 09

What's Next for Public Companies? Becoming a "Next Generation" Governance Organization

In this final chapter, we discuss how boards and senior management might respond to the ever-changing environments in which their companies operate, to maximize their viability and profitability in the near, medium and long terms. What does a "next generation" governance organization look like? We consider three critical elements to becoming a next generation organization, focusing on strategy, people, and shareholders and other stakeholders. We also cast a spotlight on the U.S. Business Roundtable's recent expanded corporate purpose statement, articulating a commitment to all stakeholders of a corporation, and consider what this might mean for directors and officers in Canada. While directors and officers are not bound to give primacy to any particular stakeholder in exercising their fiduciary duties, we increasingly see companies being pressed to be "good corporate citizens," failing which they risk damaging their brand and competitiveness and compromising their ability to generate sustained value.

What Is a "Next Generation" Governance Organization?

In our ever-changing business environment, boards and management are being pressed to systematically develop strategic approaches to achieving next-level governance that support an overarching framework of accountability, both within the organization and to shareholders and relevant stakeholders, while balancing risk and ethics with a spirit of resilience, agility and innovation.

In our view, a next generation governance organization has three critical elements. First, it is a company that has a razor-sharp focus on its business strategy and aligns all decision-making with its strategic vision and direction, taking into account short-, medium- and long-term goals. Second, this organization is people centred, harnessing the efforts, insights and creativity of everyone throughout the organization to create value and achieve successful outcomes for the business. Finally, a next generation organization proactively engages with shareholders and other key stakeholders, carefully considering stakeholder interests as part of its corporate decision-making, to allow for sustainable value generation. We discuss each of these areas in greater detail below.

MAINTAIN A RAZOR-SHARP FOCUS ON STRATEGY

A next generation governance organization focuses on strategy. It is a company that does not rest on its laurels or rely on historical advantages or strategies. Given that change is constant, boards of directors, senior management and companies that are too focused on their current business and operations and unwilling to anticipate and plan for what might be around the bend risk declining profitability and, in some cases, extinction. Forward-looking strategic value creation can help set one organization apart from another, allowing one company to thrive while another risks failure.[179]

Boards of next generation governance organizations are actively engaged in business strategy, attuned to the fact that a business model that is successful today may be vulnerable to external disruptions in the future.[180] While the CEO and the senior leadership team are responsible for developing and executing a company's strategy, governance structures should be put in place to ensure that the board also owns that strategy.

A next generation governance organization has three critical elements. First, it is a company that has a razor-sharp focus on its business strategy. Second, this organization is people centred. Finally, a next generation organization proactively engages with shareholders and other key stakeholders.

Too often, board and committee agendas are filled with backward-looking compliance items. As important as regulatory and legal compliance is, as is staying abreast of corporate governance best practices and evolving to respond to these changes, having a solely (or primarily) historical perspective can be frustrating for board members and management alike as it typically leaves little time at board meetings to talk about the future of the company. Strategy is often delegated to one- or two-day offsite sessions. However, strategy should be a continuous, iterative process, and the board should be involved in the formulation, execution and monitoring of that strategy, continuously challenging its key elements and inputs to ensure it remains relevant to the organization and responsive to the changing (and often rapidly changing) macro-environment in which the organization operates.

Strategy is often delegated to one- or two-day offsite sessions. However, strategy should be a continuous, iterative process, and the board should be involved in the formulation, execution and monitoring of that strategy.

There is no one right formula for strategic planning, and the same company may use a different approach at different points in its business life cycle. In all cases, it is critical to the strategic planning process to have access to timely and reliable information on market and economic trends, geopolitical context, competitors and customer preferences. As discussed below, shareholder and stakeholder consultation is also extremely important and can yield real insights into the viability of the strategy and whether it is being effectively communicated to the market, customers and other stakeholders that have a real impact on the business. The strategic plan's time horizon will depend on the nature of the industry and the organization's particular stage in its life cycle, but it should not simply be based on the expected tenure of the current CEO.

At a board and committee governance operational level, time should be allocated at each quarterly board meeting to have generative strategic discussions. Also, meeting agenda items (whether a discussion item or a decision item) should be linked to a prong of the strategy and, where appropriate, noted in the agenda as such. If an agenda item does not tie into the company's strategy, directors should question why the board is spending valuable time (or whether it is spending too much time) on the particular item and adjust the corporate calendar accordingly.

When boards are approving capital expenditure programs, they should also ensure that each program aligns with the company's strategy and with where it needs to be in the next year, in five years and in 50 years. The board should evaluate the capital expenditure strategy and have confidence that the process used and the absolute dollar values arrived at are for infrastructure spending and research and development programs that will further the company's goals. For example, does the budget allocate sufficient funds for innovation, including measures to respond to disruptive products and processes that may be entirely outside of the organization's control?

Spotlight: Blockbuster vs. Netflix: Anticipating Disruptive Technologies?

At its prime, Blockbuster had thousands of retail outlets and tens of thousands of employees. It had a multi-billion-dollar valuation in 2004 but then went bankrupt in 2010 and now has only one store in the world.[181] What happened? According to some sources, Blockbuster was the master of its own demise.[182] Blockbuster's initial business model of a bricks-and-mortar video rental business, which subsequently expanded organically to include convenience store features, had thrived by responding to consumers' desire for, essentially, time-shifting entertainment options, with all of the top titles in film readily available at consumers' fingertips. However, some argue that Blockbuster failed not only because of the emergence of digital technologies but also because it did not anticipate and change the fundamentals of its business model in the face of a changing business environment and evolving consumer demands.

In 2000, Netflix came on the scene. The founder of the then-fledgling company contacted Blockbuster to propose a partnership to Blockbuster's CEO and his team at the time. He proposed that Netflix run Blockbuster's brand online and Blockbuster would, in turn, promote Netflix in its stores. Netflix's proposal was rejected.[183] Netflix disrupted Blockbuster's business model first by mailing DVDs to customers and then by streaming films to customers directly into their homes. Netflix, among other new entrants including Redbox and Hulu, gave customers the same product – access to movies – without customers having to leave their homes. In response, Blockbuster continued to run its business much in the same manner it had previously – running its stores and treating its employees as if it were a convenience store, but not recognizing that its model was no longer convenient.[184] Blockbuster did eventually launch its own digital service, but by then it was too late. Blockbuster's unwillingness to change its business model, focused on physical rentals from retail stores, turned out to be one of its greatest threats. Today, Netflix is a US$127-billion company, about 25 times the value of what Blockbuster was worth at its peak in 2004.[185]

While the emergence of Netflix's disruptive digital technology was one key reason for Blockbuster's ultimate demise, it was not the only reason. Reports suggest that changing consumer views played a part in Blockbuster's decline: consumers had become unhappy with Blockbuster's model, the profitability of which in part relied on penalizing customers with late fees on rentals.[186] These late fees could double or triple the cost of renting a video, introducing friction into the consumer relationship, yet they remained a significant aspect of Blockbuster's business model despite competitive pressures. In 2000, Blockbuster drew in US$800 million through late fees alone – 16% of revenue for that year.[187] This figure dropped to US$134 million in 2009, representing 3% of revenues, perhaps reflecting a strategy shift in the face of Netflix's flat-fee system that came all too late for the company.[188]

Had Blockbuster been more attuned to the network of consumers that made up its brand and industry, it might have been better able to adapt and respond more swiftly to the evolving business environment and consumer needs. With a greater appetite to innovate to respond to the changing needs of its core business – its customers – Blockbuster might have been better positioned to prevail. Another report suggests that a key factor in Blockbuster's failure was its reluctance to change its strategy. A former UK chief marketing officer for Blockbuster provided his perspective on the biggest lesson to be taken from the Blockbuster story: "On a simplistic level, it's that if a business is in decline you need to look at what the alternative is. Instead of putting all your resource into an ailing business strategy, sometimes it is better to accept it won't be the same anymore and hit reset. Even if you're going to take a big financial hit, making a fundamental change could be more lucrative in the future."[189]

Leaders of companies cannot be expected to predict the future, but, even at the time, Blockbuster was too unwilling to adapt to what was becoming an entirely different set of customer expectations. When it comes to consuming video content, it seems that convenience is what motivates customer choice, and there was too much in the Blockbuster business model that got in the way of convenience. The case of Blockbuster is a perfect example of how depending entirely on past performance for future planning can be fatal to a company when it is faced with disruptive competitors. This reinforces the importance of including long-term perspectives in strategic planning.

An issuer's overall strategy should dictate all key decision-making, including how valuable board and committee resources are spent, as well as the issuer's capital expenditures, geographic footprint, product lines and people strategy, which is discussed next.

TAKE A PEOPLE-CENTRED APPROACH

A next generation governance organization is people centred. It harnesses the power of diverse people to bring their best thinking to the table to operate, challenge, imagine, experiment and create. It embraces the concept of recruiting, retaining, promoting and recognizing the best talent at all levels, from the board to the CEO, in senior management and throughout the company. Employees and teams should be given the resources, time and support to innovate and take measured but not undue risks. And, importantly, a next generation organization values and rewards ethical and responsible behaviour.[190]

The board of directors is also responsible for overseeing the issuer's overall people strategy and compensation philosophy. We recommend that boards (or their human resources committees) receive rigorous, regular reporting on key HR matters, including external HR trends, key HR internal data (e.g., employee engagement, turnover, internal promotions versus external hires, etc.) and key HR risks.

While boards have traditionally focused on talent at the CEO level as part of their oversight responsibilities for CEO-succession planning, the board is also responsible for overseeing its own talent pipeline. The board should be asking whether the board itself collectively has the diversity of experience, skills and backgrounds needed for the company to thrive and achieve its goals. For example, as we discussed in *Davies Governance Insights 2018*,[191] does the board have the appropriate level of human resources (HR) expertise to assist it with overseeing its human capital management? When recruiting for the board, consider a wide range of factors, including the issuer's customer base, employee demographics and geographical operations. In addition to hard skills and experience, the board should also consider what interpersonal qualities or styles the board is currently missing and may need as the company looks forward. We include an in-depth look at many of the considerations relevant to building high-performing boards in Chapter 5, In Focus: Building High-Performing Boards.

The board of directors is also responsible for overseeing the issuer's overall people strategy and compensation philosophy. We recommend that boards (or their human resources committees) receive rigorous, regular reporting on key HR matters, including external HR trends, key HR internal data (e.g., employee engagement, turnover, internal promotions versus external hires.) and key HR risks. A board should also receive periodic reporting on senior management succession planning, and not just for the CEO, and the board should be asking about the quality and success of the leadership development programs used by the company. The company's people strategy should be considered and evaluated in the context of its overall business strategy. Questions to consider include the following:

- Does the company have the right talent internally to engage with local communities in the company's foreign operations?
- Does the company have the right skills in the existing team to deliver its products or services with a greater digital mindset?
- Does the existing team have the necessary skills and capabilities to address cybersecurity risks?

Who is hired or promoted should be dictated, in part, by what the company needs to achieve, again having regard to different time horizons.

Importantly, the board, CEO and senior leadership of a next generation governance organization are responsible for ensuring a culture that encourages, rewards and incentivizes ethical and accountable behaviour by all employees. This tone, like many other corporate imperatives, is set at the top. Boards and management should actively demonstrate the ethical norms that they expect all employees to follow. The board should also ensure that employees are provided with the tools and resources necessary to help them interpret and navigate ethical dilemmas, including access to key contacts and opportunities to test how they would react to various ethical dilemmas. At minimum, this begins with ensuring that user-friendly codes of business conduct for directors, officers, employees and, increasingly, suppliers are readily available and that employees are trained, using practical examples, to understand their responsibilities. This also requires having in place effective whistleblower programs to ensure that unethical or illegal conduct, or allegations of such conduct, are promptly brought to light, investigated and resolved. Boards should also ensure that ethical behaviour is rewarded. This can be accomplished through a variety of measures, including by establishing performance metrics tied to ethical behaviour within the hiring and promotion programs.

CONSIDER SHAREHOLDER AND BROADER STAKEHOLDER INTERESTS

Next generation governance organizations increasingly recognize that the profitability and long-term viability of their businesses depend on a wide range of stakeholders, including shareholders, customers, suppliers and the communities in which their businesses operate. Boards, CEOs and senior leadership teams of next generation organizations typically work hard to create governance structures that allow for proactive and engaged dialogue with relevant stakeholders and for meaningful consideration of their interests.

Boards, CEOs and senior leadership teams of next generation organizations typically work hard to create governance structures that allow for proactive and engaged dialogue with relevant stakeholders and for meaningful consideration of their interests.

Spotlight: Business Roundtable Makes Commitment to All Corporate Stakeholders

In August 2019, the Business Roundtable (an association of CEOs of major U.S. corporations) issued its *Statement on the Purpose of a Corporation* (Statement), espousing a commitment to all stakeholders of corporations, including their customers, employees, suppliers, communities and shareholders.[192] The Statement is intended to reflect a modern standard for corporate responsibility and represents the first time since the Business Roundtable started issuing its Principles of Corporate Governance that it has departed from endorsing the principles of shareholder primacy – that corporations exist principally to serve shareholders. The Business Roundtable indicates that its new expanded language on corporate purpose more accurately describes the ways in which it and its member CEOs endeavour to create value for all stakeholders, who are “essential” and “whose long-term interests are inseparable.”[193]

The Business Roundtable urges leading investors to support companies that build long-term value by investing in their employees and communities, and the Statement’s signatories have committed to:

- delivering value to customers, including meeting or exceeding customer expectations;
- investing in employees, including through fair compensation and fostering diversity and inclusion, dignity and respect;
- dealing fairly and ethically with suppliers, including serving as good partners with those companies that help them meet their missions;
- supporting the communities in which they work, including by embracing sustainable practices; and
- generating long-term value for shareholders, including through transparent and effective engagement.

Whether directors and officers of corporations may, or must, consider the interests of stakeholders other than shareholders is a debate we have grown

familiar with in Canada over the past 20 years. The Supreme Court of Canada gave the green light many years ago to directors and officers to consider the interests of stakeholders when exercising their fiduciary duties, when it stated in its groundbreaking decision in *BCE Inc. v 1976 Debentureholders*[194](*BCE*): “it may also be appropriate, although not mandatory, to consider the impact of corporate decisions on shareholders or particular groups of stakeholders,” including “the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment.”[195] The Court thus upheld the principle that the fiduciary duty is owed not to any particular constituency but to the corporation as a whole. The Court described this duty as a “broad, contextual concept” with an eye to the long-term best interests of the corporation.[196]

Recent amendments to the *Canada Business Corporations Act* (CBCA), discussed further in Chapter 1, CBCA Reforms: Canadian Government Codifies Corporate Governance Practices, have largely codified this aspect of the *BCE* decision (while adding reference to retirees and pensioners within the group of stakeholders), by providing that in satisfying their duty to act in the best interests of the corporation, directors and officers *may*, but are not required to, consider the interests of shareholders, employees, retirees and pensioners, creditors, consumers and governments; the environment; and the long-term interests of the corporation. Consistent with the CBCA amendments and law established under *BCE*, while the Business Roundtable suggests that its signatories will consider the interests of stakeholders, it certainly does not create any obligations to do so or pronounce upon which stakeholders should, when balancing competing interests, be given primacy.

Further details about the Business Roundtable’s expanded corporate purpose statement can be found in our bulletin *Business Roundtable Issues Expanded “Corporate Purpose” Statement, with Commitment to All Stakeholder Interests*.[197]

Even while recognizing that under Canadian corporate law, shareholders elect the directors, and that under securities law, a shareholder primacy focus remains, next generation companies should strive to be attuned to and to engage with a broad range of stakeholders who matter to the success of the company. The stakeholders most relevant to an organization will invariably differ depending on the issuer's size, stage, industry and a host of other factors, but increasingly their interests can have direct and impactful effects on a company's viability and profitability.

In this context, boards should ensure that their issuers have strong and regular lines of communication with key shareholders, customers, suppliers and communities in which the businesses operate. Consider these questions, for example: Is the company attuned to customers' expectations regarding trade-offs on price, quality, delivery and training? Is the company listening to and, where appropriate, being responsive to community members' concerns about noise, safety or environmental issues? A board should ensure that there are processes in place for the company to dialogue with key shareholders and stakeholders so that they can effectively communicate the company's goals and priorities and receive stakeholder input on key issues and concerns. Importantly, stakeholder engagement should not be left until times when a crisis arises; boards should ensure that engagement is taking place systematically and that there are regular reports to the board on these processes. And boards should consider when and how to facilitate engagement between non-executive directors and stakeholders on issues that may not be appropriate to filter through management. In Chapter 8, Innovative Tools for Convenient and Transparent Disclosure and Effective Engagement, we discuss a host of tools and innovative techniques that issuers can leverage to help maximize the effectiveness of their communications and engagement programs.

Boards should ensure that their issuers have strong and regular lines of communication with key shareholders, customers, suppliers and communities in which the businesses operate.

In addition, issuers should strive to contextualize quarterly financial earnings results with other indicators of value and success by, for example, tracking and disclosing a handful of non-financial indicators of their companies' value. Doing so can provide the market with a more robust picture of the company and its success that reflects both shareholder and other stakeholder interests. Providing analysts and the markets with information that the board and management *want* to convey about the company, and not only information that analysts and markets *expect or require*, can lead to more effective engagement and build support for the company's strategy.

Finally, boards should ensure that executive compensation programs reflect the importance of stakeholders to the success of their business. In addition to establishing financial metrics to assess executive performance, consider whether it might be appropriate to use a handful of non-financial metrics, such as customer satisfaction, employee engagement and/or other environmental, social and governance measures, as part of the performance standards expected to be achieved.

Our Take: Next Generation Organizations Have Enhanced Viability and Profitability

Increasingly, public companies in Canada and abroad are facing more pressure to act as good corporate citizens and to evidence these actions, having regard to a wide range of considerations and stakeholders. Evolving your business into a next generation governance organization may be one way to respond to these requests. Next generation organizations do not take their eye off their strategy, and they ensure that all decision-making is aligned with their strategic vision. They value their employees as being core to achieving business success and provide them with the resources needed to operate, create, innovate and take measured risks. And, finally, next generation organizations ensure that they have the requisite processes in place to meaningfully dialogue with shareholders and key stakeholders, and to consider and balance a range of stakeholders' interests in corporate decision-making, to allow for sustainable value generation. In doing so, next generation organizations may find themselves building more stable, stronger and more transparent organizations, with cultures that make them more resilient, agile and innovative in the face of ever and rapidly evolving business, economic and geopolitical environments and changing customer preferences and demands.

Database and Methodology

The quantitative analysis in this report is based on data provided by ISS Corporate Solutions, Inc., and drawn from the 2019 management information circulars of 372 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, 2019. There are a total of 1,565 issuers listed on the TSX. Although the 372 Composite Index and SmallCap Index issuers included in our study make up only 24% of all TSX-listed issuers, they represent 85% of the total market capitalization on the TSX.[198]

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 241 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. Four of the 241 Composite Index issuers did not issue proxy circulars for the relevant period discussed; accordingly, our analysis is based on 237 Composite Index issuers.

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. (Our analysis includes only 59 of the issuers on the TSX 60 because, as noted above, one issuer on the TSX 60 did not issue a proxy circular during the period covered.)

- **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 issuers. (Our analysis includes only 178 of the issuers on the Completion Index because, as noted above, three 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 199 issuers, 61 of which also meet the market capitalization eligibility criteria and are part of the Composite Index.[199] (Our analysis includes only 196 of the issuers on the SmallCap Index because three issuers did not have a circular.)

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.

Notes

Chapter 1 – CBCA Reforms: Canadian Government Codifies Corporate Governance Practices

1 *BCE Inc. v 1976 Debentureholders*, 2008 SCC 69.

2 Davies, online: https://www.dwpv.com/en/Insights/Publications/2018/Governance-Insights-2018.

3 *Peoples Department Stores Inc. (Trustee of) v Wise*, 2004 SCC 68.

4 *Supra* note 2.

5 *Regulations Amending the Canada Business Corporations Regulations, 2001*, SOR/2019-258.

6 *Ibid*, section 72.2(4).

7 *Canada Gazette*, Part II, Volume 153, Number 14 (June 25, 2019), online: http://gazette.gc.ca/rp-pr/p2/2019/2019-07-10/html/sor-dors258-eng.html.

Chapter 2 – Climate Change and Sustainability: New Standards for Sustainability Reporting and Disclosures

8 Davies, online: https://www.dwpv.com/en/Insights/Publications/2018/Governance-Insights-2018.

9 Intergovernmental Panel on Climate Change, "Global Warming of 1.5ºC: Summary for Policymakers" (2018), online: https://www.ipcc.ch/sr15/chapter/spm/.

10 Government of Canada, *Canada's Changing Climate Report* (2019), online: http://www.changingclimate.ca/CCCR2019.

11 Bank of Canada, "Financial System Review – 2019," online: https://www.bankofcanada.ca/wp-content/uploads/2019/05/Financial-System-Review – 2019-Bank-of-Canada.pdf.

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Chapter 9 – What's Next for Public Companies? Becoming a "Next Generation" Governance Organization

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Database and Methodology

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To qualify for the SmallCap Index, an issuer must have a market capitalization that is at least $100 million, but not more than $1.5 billion.

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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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