Proxy Contests: Issues and Trends

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Patricia L. Olasker
polasker@dwpv.com

J. Alexander Moore
amoore@dwpv.com

ww.dwpv.com
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Activism on the Rise

Shareholder activism has been increasing at a rapid pace. In Canada, over the past 10 years, the number of proxy contests has risen from five contests in 2003 to 30 in 2012 on a steady trendline, with two extreme spikes in 2008 and 2009 coinciding with the global financial crisis.\(^1\) This trendline has continued in 2013, which is on pace to exceed the number of contests in each prior year except 2009. Factors propelling this trend include: a policy and legal focus on corporate governance; the shareholder democracy movement, for example, say-on-pay and majority voting initiatives; and increased opportunities for activism resulting from the trend in both the law and corporate governance best practices to refer matters to shareholders for approval (for example, dilutive share issuances in acquisitions and approval of poison pills).

In addition to the increasing frequency of proxy campaigns, the success rate for dissident shareholders (including settlements) has increased. While there are several factors contributing to increased success, a key factor is the greater receptiveness of the wider shareholder community to the efforts of shareholder activists. In addition to the positive shareholder returns that activists are proving they can deliver, shareholder receptiveness is increasing with the evolution away from the "corporate raider" agendas of activists in the past and toward more sophisticated approaches that have a broader appeal to the shareholder base. In particular, activists are focusing on corporate strategy, governance and board independence and putting forward their own independent director nominees.

This increasing success rate suggests that the trend towards more proxy contests will likely continue, both with existing shareholder activists feeling more confident in the prospect of success and other, historically passive, shareholders dipping their toes in the activism waters. The resource sector, in particular the junior resource sector, is Canada's traditional hotbed of activism. This can be expected to continue and increase as we continue through a period of lower commodity prices, rising capital costs and depressed M&A markets, leading to shareholder discontent.

Another trend that has attracted much attention in Canada is the increasing participation by U.S.-based funds in activist campaigns north of the border, particularly in the large-cap segment of the market. The successful campaign by Pershing Square Capital Management, L.P. in 2012 to elect its slate of nominees to the board of Canadian Pacific Railway Limited is a recent and high profile example. Other examples include:

\(^1\) Kingsdale Shareholder Services Inc.
• Northwest & Ethical Investments LP’s agitation for corporate governance reform at beleaguered Blackberry;

• JANA Partners' campaign for board change at Agrium Inc.;

• Mason Capital's opposition to the collapse of TELUS Corp.'s dual-class share structure;

• Invesco Trimark's campaign for management change at Rona Inc. in the wake of the Rona board's refusal to consider the bid by Lowe's; and

• Pressure brought to bear on Tim Hortons Inc. by Scout Capital Management and Highfields Capital Management to raise the company's leverage ratio and change its approach to U.S. expansion.

Activism has also emerged as a significant asset class, with many major institutional shareholders investing material portions of their portfolios with activist or event driven funds.

This paper discusses the activism trend in Canada and some of the principal issues and challenges faced by both activists and target companies, as well as some interesting recent developments in this field. Where notable differences arise, this paper also contrasts Canadian rules with the U.S. requirements.

1. **The Right to Requisition a Shareholders Meeting**

One of the most powerful rights that shareholders of Canadian corporations enjoy is the right of holders of not less than 5% of the issued voting shares to requisition the directors to call a shareholders meeting. On receiving a valid requisition proposing proper shareholder business, the directors must within 21 days call a meeting of shareholders to transact the business stated in the requisition. The obligation to "call" a meeting has been interpreted by the courts to be satisfied by the announcement of a date on which the meeting will be held; it is not necessary to

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

3 To be valid, a shareholder's requisition must state the business to be transacted at the meeting. In July 2013 the Ontario Superior Court of Justice in Wells v. Bioniche Life Sciences Inc. held that a requisition for a meeting to elect new directors must include the names and qualifications of the proposed nominees. In addition, the requisitioning shareholder may be required to provide information to be included in the management circular for the meeting. Failure to provide such information may relieve the directors of the obligation to call the meeting.

4 CBCA, s.143.
actually hold the meeting or even to mail notice of the meeting within the 21 days. Rather, the meeting must be held within a reasonable time determined in the good faith business judgment of the directors. What is a reasonable time will depend on the circumstances, for example, whether the requisitioned meeting pertains to a specific transaction or pending event and whether the requisitioning shareholders would be prejudiced by delay. In one recent case, the Ontario Superior Court considered 150 days to be reasonable for a requisitioned meeting called to consider the removal of the board and election of new directors. The court concluded that the decision of the board to delay the requisitioned meeting so that it coincided with the annual general meeting in order to avoid the cost of two meetings was within a range of reasonableness, and the requisitioning shareholder could not point to any specific prejudice he would suffer from the delay.5

If the directors do not call a meeting within 21 days after receiving the requisition, any shareholder who signed the requisition may call the meeting. Unless the shareholders resolve otherwise at the requisitioned meeting, the corporation is required to reimburse the shareholders for expenses reasonably incurred by them in requisitioning, calling and holding the meeting. What exactly happens when the shareholder calls the meeting is not entirely clear: the statute provides little guidance, and there is scant precedent to look to as in virtually all cases the corporation calls the requisitioned meeting. Alternatively, a shareholder can apply to the court for an order compelling the corporation to hold a meeting.

2. **Stake-Building and Beneficial Ownership Reporting**

Ordinarily, shareholders acquiring a significant position in a Canadian listed company are required to file a public "early warning" report disclosing their ownership once they acquire beneficial ownership of 10% of more of any class of equity or voting securities of the company. Upon crossing 10%, the shareholder is required to promptly issue a press release announcing its acquisition and file an early warning report within two trading days of the acquisition and must stop acquiring any further securities of the relevant class for one full trading day after the filing of the early warning report.6 Canadian early warning reporting requirements may be regarded as being more lenient than those under Rule 13d under the U.S. Securities Exchange Act of 1934, in particular because the Canadian requirement is triggered at 10% whereas the U.S. requirement is triggered at 5%. However, the U.S. rules provide a considerably longer grace period for disclosing one's position – the initial report must be filed within 10 days in contrast to Canada's requirement for an immediate press release – and the U.S. rules do not impose a trading moratorium.

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5 Marks v Intrinsyc Software International Inc. 2013 ONSC 737
Under the Canadian regime, there is a notable exception from the obligation to issue a press release and early warning report and from the trading moratorium where the shareholder is eligible to use the "Alternative Monthly Reporting System" or "AMRS". Under the AMRS, rather than issue an immediate report, the shareholder may file a report within 10 days of the end of the month in which the 10% threshold is crossed. To be eligible to rely on the AMRS, the shareholder must be an "eligible institutional investor". This includes financial institutions, mutual funds, pension funds and generally includes investment funds such as hedge funds that are managed by a registered investment advisor (including advisors registered by the Securities and Exchange Commission under the U.S. Investment Advisors Act of 1940).

Another requirement for AMRS eligibility is that the shareholder must not have any intention to make a formal take-over bid for the company or to propose a transaction which would give the shareholder effective control over the company. Notably, having an intent to propose a dissident slate at a shareholders meeting would not disqualify the shareholder from relying on the AMRS. This is in contrast to Rule 13d under the U.S. Securities Exchange Act of 1934 that requires shareholders to switch from a Schedule 13G filing to a Schedule 13D filing if their intention changes from being a passive investor to being active (for example, as a result of deciding to propose a nominee for the board or merely having the purpose or effect of influencing the control of the company). Another difference between the AMRS and Schedule 13D is that the AMRS report requirements do not specifically call for disclosure of the shareholder's intentions with respect to the board of directors or plans or proposals that the shareholder may have with respect to the company. As a result, it is possible for a significant shareholder to oppose management at a shareholders meeting and even propose its own nominees without having to provide advance disclosure.

3. Proposed Changes to Beneficial Ownership Reporting

In March 2013 the Canadian Securities Administrators (the "CSA") (the association of Canadian provincial and territorial securities regulators) proposed a substantial revision to Canada's beneficial ownership reporting regime that would affect both the early warning reporting ("EWR") requirements and the AMRS. The policy issues raised by the proposed changes are directly relevant in the United States and other jurisdictions where regulators are under similar pressure to tighten disclosure rules on stock accumulation and the disclosure of derivative ownership.

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8 NI 62-103, s.4.2.
The changes to the EWR and AMRS regimes proposed by the CSA include:

1. *Lowering the current disclosure threshold under both the EWR and the AMRS from 10% beneficial ownership of equity or voting securities to 5%.*

This proposed change has been strongly recommended to the CSA by the Canadian issuer and director community who have noted that other jurisdictions outside Canada overwhelmingly have disclosure thresholds of 5% or less.

2. *Requiring immediate disclosure upon crossing the 5% ownership threshold and imposing a one trading day moratorium on further purchases following disclosure.*

As discussed above, these are features of the current EWR regime, but currently only apply at the 10% threshold. Investors eligible to use the AMRS would continue to be exempt from the immediate disclosure requirement and the trading moratorium.

3. *Disqualification of investors from the use of the AMRS regime if they intend to solicit proxies.*

This proposed change would significantly expand the circumstances in which a non-passive shareholder would lose the ability to rely on the less onerous AMRS. However, the proposed change notably stops well short of the active/passive distinction under the Rule 13d of the U.S. Securities Exchange Act of 1934. For example, simply having the intent to meet with management and urge management to take certain action would not result in disqualification from the AMRS. In addition, it is expected that if this element of the proposed change is adopted, the rule will be clarified such that the disqualification from the AMRS for an intention to solicit would only catch intentions to conduct broad public solicitations, as opposed to limited solicitations of a small number of shareholders.

4. *Requiring enhanced disclosure under both the EWR regime and AMRS regime with respect the investor's intentions with respect to the issuer.*

The CSA has proposed to require more detailed disclosure of a shareholder's investment intentions, noting that disclosure practices under the existing rules have generally been to provide boilerplate language with little useful information for the market. The proposed changes would require both EWR and AMRS filers to disclose their plans with respect to additional purchases or sales, acquisitions of or other transactions with the issuer, potential changes to the board and any intention to solicit proxies.
5. Requiring an investor to include "equity equivalent derivatives" in calculating its share ownership for the purpose of determining whether the 5% ownership threshold has been crossed.

Equity equivalent derivatives would capture derivatives (even cash-settled derivatives) that substantially replicate the economic consequences of ownership regardless of a lack of control over the reference securities.

The CSA's proposed changes have generated a large amount of interest, with 69 comment letters having been submitted. The full text of the CSA's proposed amendments is available at http://www.osc.gov.on.ca/en/SecuritiesLaw_mi_20130313_62-104_take-over-bids.htm. Davies Ward Phillips & Vineberg LLP assisted the Alternative Investment Management Association ("AIMA") and the Managed Funds Association ("MFA") in preparing a comment letter in response to the CSA's proposal. The comment letter provides an argument against the lowering of the block reporting threshold from 10% to 5%. It also provides an extensive discussion of the importance of shareholder activism and the consequential benefits from such activity that accrue to all shareholders, as well as to target companies and the economy generally. The letter submits that the CSA's proposed tightening of Canada's block shareholder reporting rules, rather than having any beneficial effect, will stifle shareholder engagement and democracy and insulate incumbent managers from owners. The letter makes the case that engaged shareholders and activist investors serve as a check on management, contain agency costs, improve corporate governance and have been shown in a number of empirical studies to have a positive impact both on firm value and operating performance of target companies. The letter also compares the CSA's proposed amendment to the shareholder reporting regimes in other jurisdictions, including the SEC's Rule 13d, and concludes the CSA's proposed amendments would adopt some of the most burdensome elements of foreign regimes while retaining the existing strict requirements of the EWR regime that currently apply only at 10%. The full text of the MFA and AIMA comment letter is available at http://www.osc.gov.on.ca/documents/en/Securities-Category6-Comments/com_20130712_62-104_kaswellsj.pdf.

4. Competition/Antitrust Legislation

Canada's antitrust regime does not impose notification or government clearance obligations at the early stake-building stage by the activist and does not, unlike the Hart-Scott-Rodino Antitrust Improvement Act ("HSR Act") in the United States, distinguish between shareholders with passive intent and those with an intention to seek to effect change in the policies of the target company. In Canada, notification under the Competition Act is not required until the acquiror acquires more than 20% of the target's voting shares, and notification under Canada's Investment Canada Act is not required for an acquisition of less than a 1/3 voting interest in a Canadian business. In contrast, in the United States, the HSR Act can work, in effect, as an early warning system requiring notification of the target and government clearance at the early stake-building stage and a lengthy moratorium on purchases after the filing with the regulatory authority.
5. **Group Formation – Insider Trading and Joint Actor Characterization**

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

Under Canadian securities legislation, a person in a "special relationship" with a public company is precluded from trading with knowledge of material information that has not been generally disclosed. The prohibition extends to anyone who learns of material information from a special relationship person. The category of "special relationship" persons is large and includes a person that beneficially owns more than 10% of the voting securities of the target company. Thus, if the activist is a 10%-plus shareholder of the target, the activist will be a person in a special relationship with the target. Non-public information that the activist may learn in its discussions with the target company about, for example, the target's business plans or its response to the activist's proposals may amount to material undisclosed information which, if communicated from the activist to the institutional shareholder, will restrict that shareholder's ability to trade.

The second concern relates to the issue of "joint actor" characterization which under Canadian securities law is relevant both for purposes of the early warning disclosure requirements and for compliance with Canada's take-over bid regime. Under Canadian securities legislation, if the dissident has an agreement, commitment or understanding with another shareholder that they intend to exercise their voting rights in concert, they will be presumed to be joint actors. If the agreement, commitment or understanding is with respect to the acquisition of shares of the target company, they will be deemed to be joint actors. As a consequence, their holdings will be aggregated for purposes of determining whether the 10% early warning disclosure obligation has been triggered, and the joint actor will have to be named in the activist shareholder's early warning report.

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

Many Canadian and U.S. public companies have adopted poison pills that provide if an "acquiring person" exceeds a specified level of ownership (typically 20%) all shareholders other than the acquiring person can purchase stock at a substantial discount to the market price of the shares, resulting in significant dilution to the acquiring person. Canadian poison pills, like U.S. pills, treat an acquiring person as the beneficial owner of shares owned by its joint actors. However, Canadian pills have evolved differently from U.S. pills due to the fact that the Toronto Stock Exchange requires that pills be approved by shareholder vote. This has given shareholders and ultimately Institutional Shareholders Services Inc. ("ISS") considerable influence over their terms. One of the ways in which Canadian pills differ from U.S. pills is that typically the definition of "joint actor" will not include persons with whom the acquiring person has an agreement to jointly vote shares, but rather only persons with whom the acquiring person has an agreement with respect to the acquisition of shares. That said, although this would be true in the vast majority of cases, for Canadian companies not followed by ISS, or listed on a U.S. stock exchange, the U.S.-style definition may be used, so the poison pill requires careful consideration in each case, as there remains a possibility that an activist's plans to vote shares together with other shareholders could trigger the poison pill.

7. **Selective Disclosure**

In Canada, the extent to which an activist can communicate information to other shareholders is not entirely resolved. Disclosure by a "special relationship" person (like a 10%-plus shareholder) to another person constitutes "tipping" under Canadian securities law. Tipping is prohibited regardless of how the tipper acquired the information and regardless of whether the tippee enters into a confidentiality agreement.

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

The only general exception from the prohibition from tipping is for disclosure made "in the necessary course of business". What is unresolved is whether these words mean "in the necessary course of the company's business" – to allow communications between an issuer and its counsel or an issuer and its lender, for example – or whether they can be read to mean "in the necessary course of the tipper's business". Given this uncertainty and given the activist's susceptibility to challenge, in our view activists should exercise caution in communicating information to their joint actors or other shareholders whose support they are seeking.
8. **Voting Shares Acquired After the Record Date**

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

9. **Empty Voting: TELUS/Mason**

The issue of empty voting (the wielding of voting power without a corresponding equity interest) garnered significant attention in 2012 as a result of Mason Capital Management's opposition to a capital reorganization proposed by TELUS Corp. to collapse its dual-class share structure.

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

Mason's strategy was initially successful. With Mason having the right to vote 19% of the outstanding voting shares on a resolution that required two-thirds approval of those shares represented at the meeting, TELUS determined that the share collapse proposal would not pass and withdrew the proposal from the agenda for its May 2012 annual meeting. However, in its announcement, TELUS stated its commitment to effecting a share collapse on a one-for-one basis.

Subsequently, Mason submitted a requisition for a meeting of shareholders to consider a proposal to amend TELUS's corporate charter to enshrine a requirement for the payment of a premium to the holders of the voting shares in connection with any collapse of TELUS's dual class share structure. TELUS rejected Mason's requisition on a number of grounds and
announced a revised proposal to collapse the dual class share structure, again on a one-for-one basis, in a transaction structured in a manner that would only require approval of a majority of the voting shares. Under this revised structure, Mason was much less likely to be able to block the approval of the collapse.

The BC Supreme Court declared Mason's requisition was invalid on a number of technical grounds. Although the court did not rule on the "empty voting" issue, it issued a strong statement against empty voting, stating in obiter that a court might use its power to deny an empty voter the right to requisition a meeting. On appeal, the British Columbia Court of Appeal reinstated Mason's requisition and disagreed with the lower court's statement that the courts have the authority to intervene in cases of empty voting on broad equitable grounds, stating that any remedy must lie in legislative or regulatory change.

Ultimately, the TELUS share collapse proposal was approved. In the final court proceeding (to approve the plan of arrangement pursuant to which the collapse was effected) the British Columbia Supreme Court was again critical of Mason's tactics and considered Mason's lack of economic interest despite its voting interest to be relevant to the court's consideration of Mason's objections to the fairness of the collapse. However, Mason's right to vote its shares, despite its lack of a commensurate economic interest, was never in doubt.

Although TELUS was ultimately successful in accomplishing its share collapse, the contest with Mason highlights the complexity of the empty voting issue and the uncertainty as to how courts will deal with it. The CSA's proposed changes to beneficial ownership reporting discussed above include enhancements to disclosure obligation aimed at identifying situations where empty voting might exist. However, the CSA proposals will not effect any change in the substantive rights of an empty voter: this would likely require amendments to the statutes governing Canadian corporations.

10. **Classified Boards**

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

11. **Short Slate Proposals**

Historically, short slate proposals have been relatively infrequent in Canada, with most contests involving proposals to replace the entire board. Where they have occurred – usually instigated by U.S. rather than Canadian activists – they have typically been unsuccessful notwithstanding that the policies of proxy advisory firm ISS favour short slate proposals.
Nonetheless, given the success of Pershing Square's short slate at Canadian Pacific Railway, one might expect to see more frequent short slate proposals.

12. **Limited Private Proxy Solicitation and Advance Notice Bylaws**

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

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

The ability to ambush a shareholders meeting has been facilitated by the absence from the Canadian corporate governance landscape of advance notice by-laws that would require a dissident shareholder to give advance notice of its director nominations in order for the nominations to be ruled valid at the meeting. However, Canadian issuers are waking to the merits of adopting advance notice by-laws to frustrate these tactics. As a result of a June 2012 decision from the Supreme Court of British Columbia in *Northern Minerals Investment Corp. v. Mundoro Capital Inc.*[^10] ("Mundoro"), the adoption of advance notice by-laws and the principles underpinning their use have now been judicially condoned. The court in *Mundoro* held that the directors have the power to impose such a requirement pursuant to their residual powers to manage the business and affairs of the corporation. Rather than infringing shareholder rights, the court held that such a policy in fact ensures an orderly nomination process and that shareholders are informed in advance of a meeting of what is in issue and prevents a "group of shareholders from taking advantage of a poorly attended shareholders meeting to impose their slate of directors on what could be a majority of shareholders unaware of such a possibility arising".

The *Mundoro* decision is particularly notable as the company in that case adopted its advance notice policy after its shareholder meeting had been called and the management circular mailed. As a result, a dissident cannot take for granted that the absence of an advance notice by-law in a particular case means that a limited behind the scenes solicitation for support of its nominees will be successful.

[^9]: CBCA, s.150(1.1) and NI 51-102, s.9.2(2). This exception is not available to management of an issuer or those acting on behalf of management.

[^10]: 2012 BCSC 1090.
Even prior to the *Mundoro* decision, a handful of Canadian companies had adopted advance notice by-laws. The *Mundoro* decision has encouraged other companies to do so. In addition, ISS Canada has now spoken on the subject and has indicated in its 2013 Proxy Voting Guidelines that while advance notice by-laws will be considered on a case-by-case basis, ISS will generally support them if the company's deadline for notice of shareholders' nominations of directors is no more than 65 days and no less than 30 days prior to the meeting date. Since *Mundoro* more than 600 Canadian companies have adopted advance notice by-laws, among them Barrick Gold Corporation, Bombardier Inc. and Hudson's Bay Company.

13. **Public Proxy Solicitation and the Broadcast Exemption**

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

Pershing Square's successful campaign to elect its nominees to the board of Canadian Pacific Railway serves as a good example of the utility of the broadcast exemption to activists, and the flexibility it affords to engage in a robust solicitation campaign, particularly in the early stages, without incurring the additional costs and burdens of mailing a dissident information circular. In the case of Pershing Square, reliance on the exemption, combined with the filing of an initial "pre-emptive" proxy circular, enabled Pershing Square to mount a multi-faceted solicitation campaign involving public "town hall" meetings, press releases, speeches, media interviews, shareholder one-on-one meetings and a customized website, over the course of months and long before Canadian Pacific Railway's management had filed its proxy circular.

14. **Compensation Arrangements for Director Nominees**

One of the challenges faced by an activist is recruiting good board candidates for a dissident slate and, importantly, committing them to the activist's vision for the target company. Some activists have structured compensation arrangements for director nominees to address these challenges. In two high profile proxy contests in 2013, one in Canada and one in the United States, this practice came under attack.

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11 CBCA, s.150(1.2) and NI 51-102, s.9.2(4).
12 NI 51-102, s.9.2(6). Compliance with the broadcast exemption entails other obligations, which are not discussed as they are beyond the scope of this article.
In Canada, in the proxy contest in which U.S. hedge fund JANA Partners sought to have five nominees elected to the board of Agrium Inc., JANA entered into arrangements with its five nominees to pay them a fixed cash payment of $50,000 each plus a profit participation interest in any profit JANA Partners generated from its ownership of Agrium shares over a three year period.

JANA Partners' compensation arrangements with its nominees became a focus of Agrium's attack on JANA in the contest. Agrium labelled the profits participations as "golden leashes" around the necks of JANA Partners' nominees that compromised their independence. JANA Partners defended the arrangements noting that the arrangements did not impose any obligation on the nominees other than to stand for election and that the profits participations were designed with a view to aligning the interests of the nominees with the interests of Agrium shareholders.

JANA Partners' nominee compensation arrangements likely weighed on JANA Partners' ability to gather the necessary shareholder support in a close contest. The compensation arrangements drew a strong negative comment from proxy advisory firm Glass, Lewis & Co., and several shareholders also noted their opposition. In particular, Alberta Investment Management Corporation issued a public release declaring its support for Agrium's incumbent board in which it noted concerns that JANA Partners' compensation of its nominees could have negative effects on the board, including lack of independence, fragmentation noting and reduced efficacy. The Canada Pension Plan Investment Board also noted its concern with JANA Partners' compensation arrangements in its announcement of its support for Agrium's board.

At the same time that JANA Partners was waging its contest with Agrium, Elliott Management Corp. was engaged in its own proxy fight with Hess Corp. in the United States. Like JANA Partners, Elliott Management had entered into compensation arrangements that would provide performance incentives to its nominees which were the subject of strong criticism from Hess. Citing the ongoing distraction caused by the compensation issue, shortly prior to the Hess shareholders meeting Elliott Management's nominees agreed to waive their compensation arrangement should they be elected to the board. On the same day that this concession was announced, Hess and Elliott Management announced a settlement that saw two of the dissident's nominees elected. The timing of the waiver and the settlement suggests that compensation arrangements might have presented an obstacle in the settlement discussions.

While compensation during the pendency of a proxy contest will likely continue to be acceptable, post-election compensation arrangements funded by the activist will be scrutinized by shareholders, and activists will need to consider whether offering compensation, while helpful in attracting candidates, will alienate shareholders and jeopardize chances of success.

15. **Proxy Access – Nominations for Director Through Shareholder Proposals**

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

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

The corporation can reject a proposal on a number of grounds, including where it appears that the proposal does not relate in a significant way to the business or affairs of the corporation. In addition, a corporation is not required to include a shareholder proposal in its management proxy circular if it is not submitted to the corporation at least 90 days before the anniversary date of the notice of meeting that was sent to shareholders in connection with the previous year's annual meeting.

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

Interestingly, despite the great interest in proxy access among shareholders, including the continuing push by the U.S. shareholder community for improved proxy access over the past several years, these Canadian provisions (which are similar to U.S. rules for shareholder proposals) have rarely been used. This is likely due to four factors:

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13 CBCA Regulations, s.46.
14 CBCA, s.137(4).
15 CBCA, s.137(5)(a) and CBCA Regulations, s.49. Other corporate statutes (such as the Business Corporations Act (Ontario)) calculate the deadline differently.
16 "Solicitation" includes, among other things, a "communication to a shareholder under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy". CBCA, s.147. See also National Instrument 51-102 – Continuous Disclosure Obligations ("NI 51-102"), s.1.1, "solicit".

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First, the deadline for submitting a proposal typically occurs four to six months prior to a meeting date and has often passed before a dissident has firmed up its plans to take action.

Second, the statutory word limitations are not conducive to advocacy. The proposal and the statement in support of it together cannot exceed 500 words.

Third, as discussed above, shareholders with 5% of the shares already have the right to requisition a meeting. The deadline for requisitioning a meeting will typically occur much later than the deadline for submitting a proposal. Thus, any shareholder considering submitting a nomination via a proposal could instead submit a requisition at a later date and then agree with management that the requisitioned business (e.g., to elect the dissident's nominees) could be dealt with at the annual meeting instead.

Fourth, mere inclusion of a dissident's nominees in management's circular and on management's proxy card is generally not viewed as being sufficient to give a dissident any significant likelihood of success unless the initiative is accompanied by a robust solicitation effort by the dissident. Moreover, management has considerable control over how the dissident's nominees are presented in the circular and the management proxy card. Thus, a dissident will typically prefer to mail their own circular to present their nominees and use their own proxy card.

16. Universal Proxy

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

The ability to use a universal proxy in Canada allows the dissident to offer shareholders the choice to pick and choose among all candidates for election. For many shareholders, this makes the dissident card a more attractive option as they can tailor their vote, voting for the combination of management and dissident nominees that they think makes most sense. For example, where a shareholder is supportive of a dissident, but believes that the dissident slate put forward is too large, a universal ballot would allow the shareholder to vote for a subset of the dissident nominees and also vote for one or more management nominees.
A universal proxy was first used successfully in Pershing Square's proxy contest for Canadian Pacific Railway. In that contest, both sides ended up using universal proxy cards—management presumably doing so pre-emptively so that its card would not be viewed as less flexible than Pershing Square's. The use of universal proxies required customization to Broadridge's online voting system, which resulted in considerable additional expense to Pershing Square. However, those system enhancements should be available to accommodate universal proxies in future contests without undue costs.

17. Vote Buying: Soliciting Dealer Fees in Proxy Contests

The high profile proxy contest in which JANA Partners sought to have five nominees elected to the board of Agrium Inc. brought under scrutiny the practice of companies compensating brokers for soliciting favourable votes from retail shareholders.

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

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

In 2012, management of Enercare Inc. formed a soliciting dealer group to compensate brokers for securing votes in favour of the incumbent board's re-election. Although the dissident in that case objected and the practice drew some criticism, because of the low profile of the contest and the fact that the votes of retail shareholders were not material to its outcome, the issue did not garner much notice at the time.

17 The dissidents in Biovail Corporation's 2008 proxy contested also used a form of universal proxy, but were unsuccessful in that campaign. The dissidents also encountered technical difficulties with Broadridge Investor Communications Solutions ("Broadridge") accepting online voting instructions on the dissident card.
In contrast, the discovery by JANA Partners of the soliciting dealer fees offered by Agrium in its 2013 proxy contest generated intense media coverage and reaction from shareholders and focused attention on the propriety of the practice, not only in proxy contests for board elections but also in the context of M&A. In Agrium's case, the company entered into an arrangement in which brokers would be paid $0.25 per share for each shareholder voting in favour of management's slate, with payment conditional on the successful election of all of management's nominees. These arrangements were not disclosed publicly and were only discovered by JANA Partners in the final week of the contest.

Shareholder and public reaction to Agrium's use of the soliciting dealer fees in the context of the election of directors was overwhelmingly negative. Numerous shareholder organizations and commentators condemned the practice, particularly in the context of a board election. Notably, the Canadian Coalition for Good Governance published an op-ed piece in Canada's Globe and Mail newspaper asserting that Agrium's "vote buying" was inconsistent with the basic tenets of shareholder democracy and the fiduciary duties of directors. The Globe and Mail also published an editorial criticizing the Agrium board for the practice.

Certainly, the payment of soliciting dealer fees by a board to assist it in getting re-elected raises a number of legal issues. First and foremost is whether it is a proper use of corporate power vested in the board to authorize the use of company funds to create incentives for brokers to obtain votes from their clients in support of the incumbents’ re-election. Canadian courts have held that the best interests of the corporation in the context of a contested shareholders meeting center on the maintenance of the integrity and propriety of the voting procedure. Agrium's purported rationale for paying the fees in its case was to increase the participation of retail shareholders in the meeting. However, the terms of the payment did not reward brokers merely for getting their clients to vote, rather only providing for payment if the votes were in favour of the incumbent board and the incumbents were successfully elected. As a result, Agrium's soliciting dealer fees undermined the company's best interests by creating conflicts of interest for brokers that would inevitably lead to some shareholders voting in favour of the incumbent's re-election based on a recommendation prompted by a financial incentive, and not based on an objective assessment of the best slate to govern the company. The use of company funds to achieve such a result might well be found by a court to be a breach of the directors' fiduciary duties.

Agrium's failure to disclose the payments also raised issues of compliance with the disclosure requirements applicable to the company's proxy circular. In all other cases where soliciting dealer fees had been paid in M&A transactions and in the single other example in a proxy contest, the fee arrangements were either disclosed in the company's circular or in a subsequent press release. The failure to disclose the arrangement meant that shareholders would have been unaware of the conflicts of interest that their brokers were subject to in providing their voting recommendations.
The controversy arising from Agrium's use of the soliciting dealer fees has also raised questions about the legality of the brokers' participation in the practice under Canadian law. It has been noted that dealers in the United States will not engage in the practice on grounds that by taking compensation for soliciting votes they would run afoul of proxy solicitation rules in Rule 14a-2 under the Securities Exchange Act of 1934. Some have asserted that, in contrast, nothing prohibits the practice in Canada. However, interestingly, Canadian proxy solicitation rules are substantially similar to the rules in the United States that are cited as prohibiting the practice. We believe that securities regulators are examining the existing rule framework and considering whether new rules to prohibit the practice are necessary. In the meantime, because of the negative reaction of shareholders and the press to the practice, we would not expect the practice to be seen again in a contested board election.

18. Regulatory Developments with respect to Proxy Advisory Firms

Concerns among market participants about the functioning of the proxy voting system in both Canada and the United States have been gaining prominence. In 2010, our firm published a white paper on the Canadian proxy voting system, titled The Quality of the Shareholder Vote in Canada (a copy is available at http://www.dwpv.com/Sites/shareholdervoting/Download.htm), detailing the complexity of the proxy voting system and noting several areas of deficiency. Since the release of the paper in 2010, there have been continued discussions in the shareholder voting industry about the need for reform.

One of the issues raised in our paper related to the role and influence of proxy advisory firms, like ISS. In June, 2012, the Canadian Securities Administrators (the "CSA") released an invitation for comment (due September 21, 2012) on the potential regulation of proxy advisory firms. The particular areas on which the CSA sought comment related to:

- potential conflicts of interest arising from advisory firms' consulting activities;
- lack of transparency in how proxy advisory firms arrive at their recommendations;
- potential for inaccurate analysis and limited opportunity for issuer engagement;
- the influence of proxy advisory firms on corporate governance practices; and
- the extent of reliance by institutional investors.

Issuers were almost unanimous in calling for some form of regulation or oversight of proxy advisory firms. A number of issuers cited their own particular experiences with voting recommendations that were based on inaccurate information or flawed analysis. The degree of regulation suggested by issuers varied, with some issuers calling for oversight of proxy advisory firms that is akin to the regulation that has been imposed on credit rating agencies. Others took the view that their concerns could be adequately addressed by proxy advisory firms voluntarily adopting better practices in respect of conflict of interest disclosure and shareholder engagement.
Shareholders commenting on the proposals were almost universally supportive of no regulatory intervention in the role proxy advisory firms play. Shareholders generally noted the important role that proxy advisory firms play in helping them make informed voting decisions and the positive impact that proxy advisory firms have on improving shareholder engagement and corporate governance in Canada. Shareholders generally disagreed with widely held perceptions that proxy advisory firms have considerable influence over vote outcomes or that proxy advisory firms' reports are frequently based on flawed analysis.

The proxy advisory firms themselves provided comment letters in which they explained their internal procedures for dealing with conflicts, generating reports and recommendations, and engaging with their client base and issuers. Both ISS and Glass Lewis noted steps that they had taken in recent years to respond to concerns in the marketplace, particularly with respect to disclosure of potential conflicts of interest and engaging with issuers. Their comment letters are in fact a useful resource for issuers and their advisors who may be seeking a better understanding of the vote recommendation machinery and how they can engage with proxy advisory firms.

19.  **Emerging Fairness Doctrine in Proxy Fights**

An important backdrop to any proxy fight in Canada is the availability of the so-called "oppression remedy" to shareholders under Canadian corporate law. The oppression remedy is available to shareholders whose "reasonable expectations" have been "unfairly prejudiced", "unfairly disregarded" or "oppressed" by the actions of the directors. In the context of a proxy fight, a shareholder's reasonable expectations would include the right to exercise its voting franchise without undue interference or coercion from the board of directors.

The oppression remedy provides the courts with a broad-ranging authority and discretion to remedy a wrong to individual complainants. In oppression cases, the courts apply an "effects-based test", and can grant remedies even where bad faith or improper motives are not established. It is not unusual for dissident shareholders to claim oppression in response to actions taken by the target board of directors in context of a proxy fight. Successful claims can result in the invalidation of a meeting result and a requirement to hold a new meeting.

In the August 2012 case of *International Energy and Mineral Resources Investment (Hong Kong) Company Limited v. Mosquito Consolidated Gold Mines Limited* ("Mosquito"), the oppression remedy was invoked by a dissident shareholder who complained that management's proxy solicitation firm was using a telephone voting system called "Televote" through which proxy solicitation agents would take voting instructions orally over the phone from retail shareholders. In addition to finding that the use of Televote was oppressive because of the lack of safeguards to ensure that voting instructions could be authenticated, the court also

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18 CBCA, s.241.
19 2012 BCSC 1191.
noted that the use of Televote by the management side after the dissidents had emerged and the contest began created an obvious imbalance in the way votes were taken between management and the dissident group and that this gave management an "unfair advantage".

The Mosquito case confirms the value of the oppression remedy as a tool that dissidents may be able to use to counter actions that management might take to secure an advantage in a proxy contest. The case also emphasizes the need for management and dissidents alike to implement an equitable vote taking system that does not give either party an unfair advantage.