

2014 Canadian proxy primer

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In a new era of shareholder activism, engagement is key and corporate secretary's role takes on more significance

Canadian board members have learned anything in recent years it is that when things change, they change fast. Spurred by a slew of high-profile proxy contests (along with a surge in more discreet approaches to corporate transformation), boards are discovering that the once 'clubby' atmosphere within the Canadian corporate establishment has swiftly given way to a new era of activism, with formerly inert institutional investors now much more disposed to question both performance and governance issues.

'Pershing Square's successful proxy battle with Canadian Pacific in 2012 was a watershed,' says Glenn Keeling, executive vice president of CST Phoenix Advisors. 'It was a very public demonstration that shareholders are no longer willing to simply vote with their feet. They know their rights and have seen how activism can positively affect performance. Directors are waking up to the reality that they are vulnerable, that no company is immune from increasingly sophisticated activism and that there is a desperate need to be better prepared.'

The first step toward such preparedness is staying connected with the investor community. Traditionally this has been accomplished largely through the investor relations (IR) function – but traditional IR is no longer enough. 'It used to be that someone in the IR group occasionally contacted shareholders to get a feel for their concerns and sentiment,' says Brad Allen, founder of Branav Shareholder Advisory Services. 'Those days are gone. Directors are realizing this is a key strategic risk area and are actively looking for more effective ways to obtain independent feedback from investors on governance issues, strategy and performance.'

Learning to listen

To spur more dialogue, companies are experimenting with new ways of consulting with shareholders, including surveys, board blogs, governance-related conference calls and investor roadshows that include board representation. Still, despite a clearly vested interest in knowing first-hand what investors think, and despite the growing institutional clamor for more engagement, Allen believes few boards have yet to aggressively take up the challenge. 'Real engagement is best done face to face,' he says.

Allen thinks concerns about directors selectively disclosing information are unwarranted as 'board members are generally too smart for that. More to the point, when they do engage in face-to-face communication, they aren't there to talk; they're there to listen. It's about boards demonstrating an ongoing interest in investor concerns and willingness to give them due consideration.'

How far a board wants to take engagement depends on individual company circumstances, but there is no doubt the role of corporate secretary is taking on increasing importance. 'Corporate secretaries are a corporation's eyes and ears on the shareholder community's governance agenda,' says Carol Hansell, founding partner of law firm Hansell. 'They possess an enormous amount of knowledge about the players, emerging trends and hot-button issues that could affect a shareholder vote. They need to be working closely with IR and searching for more effective ways of bringing that information before management and the board.'

Thwarting the ambush

In the search for solutions to shareholder activism, more and more Canadian companies are tweaking their corporate organizations with bylaw provisions intended to thwart sneak attacks. Among these are the adoption of advance notice requirements and enhanced quorum bylaws in the case of director nominations by shareholders. Following a judicial green light in 2012, hundreds of Canadian companies – mostly smaller issuers in the oil & gas sector – have adopted advance notice provisions, and observers fully expect the trend to continue in 2014.

'Until a couple of years ago, you could count on one hand the number of Canadian companies that had adopted advance notice provisions,' says Andrew MacDougall, a partner at law firm Osler Hoskin & Harcourt. 'Last year the floodgates opened and now it's become common practice.'

MacDougall says that when they are properly drafted, advance notice provisions have not proven controversial among either shareholders or proxy advisers. 'If you add so many bells and whistles that it significantly impedes the nomination of a director, you won't fit within ISS or Glass Lewis guidelines and it will be harder to get shareholder support,' he explains. 'Aside from that, these provisions aren't really a problem. Shareholders understand the concept is to allow everyone to make an informed decision with no last-minute surprises.'

A complementary but perhaps less well-known governance tool is the enhanced quorum bylaw. As developed, where a change in the majority of the board is at stake, it requires that the normal quorum of a company (which can be set as low as 10 percent) be bumped up to 50 percent of the issued and outstanding shares. Failure to meet the quorum requirement results in a meeting adjournment lasting as long as two months, during which time the company and activist shareholders are expected to get their message out to a broad group of shareholders.

'It basically buys the company time to respond and formulate a strategy if taken by surprise,' says Allen. 'Companies can institute it as a bylaw subject to subsequent affirmation at the next shareholder meeting.'

Room for disagreement

Companies should be aware, however, that ISS won't see eye to eye with them on this. Holding that all matters voted on at shareholder meetings are of equal importance, ISS' new policy explicitly states that it will not support bylaws that establish a different quorum for meetings where half or more of incumbent directors may be replaced.

'How much influence ISS has with your company's shareholders will determine how hard you have to work to get [an enhanced quorum bylaw] passed,' comments Allen. 'But if a company can state its case cogently to key shareholders, it doesn't matter what ISS says.'

Still, while useful in preventing an ambush, none of these tools can ultimately defeat a truly dedicated activist. David Salmon, senior vice president at Laurel Hill Advisory Group, says boards must acknowledge shareholder needs and be proactive in addressing expectations. He points to the conceptual interplay of director accountability, independence and engagement as a defining element in 2014's proxy season and beyond.

'Tactical defenses won't suppress the overall level of activism,' says Salmon. 'We expect it to grow this year and in the future. That's because investors want to see higher standards at the boards of companies in which they invest. If boards aren't prepared for sufficient engagement, questions about independence and accountability can only grow.'

That sort of uncertainty, when combined with poor corporate performance, tends to engender conflict, notes Salmon. 'And in today's world, no company or board can afford to head into proxy season without the maximum possible trust and goodwill of shareholders.'

Rosenfeld's Warning

While a policy of strong shareholder engagement at the board level can indeed go a long way toward building shareholder goodwill and even offer the opportunity to defuse potential concerns before they get out of hand, corporate performance remains the ultimate measure of shareholder satisfaction.

'If boards and companies in Canada want to stay out of activists' sights, they mustn't allow a value gap to form between where their stock is trading and where it could be trading,' says Eric Rosenfeld, a New York-based activist and founder of Crescendo Partners. 'Companies need effective strategies and they need to communicate them in such a way that shareholders support them.'

'A strategy not supported by shareholders will result in either a change of shareholders – or someone coming along who causes you to change strategy.'

Rosenfeld, an activist for more than 30 years, sees Canada as an activist-friendly jurisdiction with shareholders who are increasingly willing to back a worthy cause.

'Investors in Canada have repeatedly seen how effective activism can be,' he explains. 'They have learned that they don't have to sell their shares if they aren't happy with a company's direction and can instead effect change by being activists themselves or – probably better – supporting an experienced activist to help make that change. We love Canada.'

New Electronic Avenues

Canadian firms are increasingly turning to new technologies to help in the proxy effort. For example, Canadian securities laws now allow issuers, without prior shareholder consent, to send proxy materials electronically instead of mailing out paper copies. Under the notice and access procedures, shareholders receive, with their proxy card, a one-page paper notice containing meeting details, a brief description of voting matters, and information on how to find the proxy materials online or request a paper copy.

Last year around 200 companies took advantage of notice and access, and Andrew MacDougall of Osler Hoskin & Harcourt believes the number will rise dramatically this year. 'Initially, many companies had a 'wait and see' approach,' he notes. 'The US experience suggested the possibility of a dramatic drop-off in retail votes, and firms were reluctant to adopt a new system until they had a better idea of how shareholders would react. By and large, it seems Canadians reacted favorably and cast their votes.'

Along with savings in printing and distribution, MacDougall sees electronic delivery of proxy materials as revolutionizing circular content and design. 'Rather than trying to condense everything in a way that minimizes paper, companies have the opportunity to produce more attractive and user-friendly documents,' he explains, noting that electronic documents can make it easier for investors to navigate to

sections of particular interest. 'Content such as a section highlighting governance best practices or a brief outline of compensation practices and trends can be provided in an easy-to-view format. There is great value in being able to articulate in a nutshell what is otherwise contained in the highly detailed compensation discussion and analysis.'

Still, notice and access isn't for everyone. It's not available to investment funds, some estimates suggest it may not be financially advantageous below a threshold of 5,000-6,000 shareholders, and concerns remain about its potential to dampen voter turnout.

'Companies worried about potential shareholder resistance to special items such as an options plan should wait another year or so until we have a better idea about the actual impact of notice and access on voter turnout,' cautions Victor Li, vice president of proxy analytics at Kingsdale Shareholder Services.

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