

Corporate Securities Law

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Annual Meeting Results Invalidated Due to Improper Telephone Proxy Solicitation

In the recent decision of *International Energy and Mineral Resources (Hong Kong) Company Limited v. Mosquito Consolidated Gold Mines Limited*, 2012 BCSC 1191, the Supreme Court of British Columbia considered a claim by a dissident group of shareholders that the results of a contested shareholder meeting should be invalidated, principally (but not exclusively) because the use of the telephone proxy solicitation system (“**TeleVote**”) by the Company’s proxy solicitor was “oppressive and unfairly prejudicial”. The court found the use of TeleVote – which is a relatively new approach in Canada to solicit votes from shareholders over the telephone – and certain other elements of the conduct of the meeting to be oppressive to the dissident’s reasonable expectations regarding how the meeting would be conducted and invalidated the results of the meeting and ordered that a new vote be held – without TeleVote being used.

Background

Mosquito Consolidated Gold Mines Limited (“**Mosquito**”) is a mineral exploration and development public company whose shares trade on the TSX Venture Exchange. On December 16, 2011, Mosquito held its annual and special meeting of shareholders (the “**AGM**”) at which, among other things, shareholders were asked to choose between two competing slates of directors – one nominated by management and one nominated by a group of dissident shareholders. Both Mosquito and the dissidents retained proxy solicitors to encourage shareholders to vote for their respective nominees.

As part of its proxy solicitation effects, Mosquito’s proxy solicitors used its TeleVote system to proactively gather votes directly from shareholders. Through TeleVote, call centre operators employed by the proxy solicitor call shareholders and encourage shareholders to

authorize proxies to be cast in favour of management’s resolutions. If the shareholder is prepared to do so, the operator takes verbal voting instructions, which the proxy solicitor uses to execute a proxy or voting instruction form on the shareholder’s behalf. While the conversations are recorded and any instructions received are noted in an electronic database, in contrast to traditional electronic voting systems such as those that provide for automated telephone voting using a touch-tone phone that are accessed by shareholders using a personal identification numbers included in the proxy materials, no other steps are taken to verify the identity of the person who provided the voting instructions or to confirm that they had the authority to exercise voting rights in respect of the relevant shares. The main safeguards of TeleVote are the use of a shareholder’s postal code and the delivery of a confirmation letter to be sent to the security holder within three business days.

The use of TeleVote was not specifically mentioned in management’s proxy circular, the proxy or any of Mosquito’s four news releases issued following management’s proxy circular, although the proxy circular did note that proxies might be solicited by telephone. Although no shareholders of Mosquito other than the dissidents claimed that they had been oppressed, the dissidents provided evidence that at least some other shareholders did not appreciate that they were giving voting instructions when speaking to a TeleVote operator.

At the AGM, the dissidents objected to votes cast by TeleVote, but the meeting Chair chose to recognize those votes, and management’s slate of directors was elected by a narrow margin. Had the votes cast through TeleVote been rejected, the dissidents’ slate would have prevailed.

In considering the dissidents’ oppression claim, the court followed the two-pronged test set out by the Supreme Court of Canada in *BCE Inc. v 1976 Debentureholders*, 2008 SCC 69:

- was the conduct of the AGM – including the use of TeleVote – contrary to the reasonable expectations of the dissident group; and
- if a breach of a reasonable expectation was established, was the conduct complained of “oppressive” or “unfairly prejudicial”.

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Conclusion

The court concluded that the dissident group had a reasonable expectation that the voting procedures used in advance of and at the AGM would be conducted in a manner consistent with accepted methods and protocols, and consistent with the methods disclosed in the management information circular and that the voting procedures used by Mosquito were inconsistent with that expectation.

In reaching its conclusion that the reasonable expectations of the dissident group were not met, the court identified a number of specific concerns regarding TeleVote, including that:

- *Oral grant of authority insufficient* - Reliance on an oral grant of authority for the TeleVote process without a direct and immediate link to a verifiable, written confirmation, was inconsistent with legislative requirements.
- *No unique identifier* - The use of a shareholder's postal code was an unreliable means of identifying the person giving instruction, and that the effectiveness of confirmation letters could not be verified as they depend upon the actual receipt and review by shareholders.
- *No complete record* - The record, comprised of a print-out of the votes entered into a computer system and a blank proxy and voting instruction form executed by the proxy solicitor, could not be readily checked or verified.
- *Agency relationships* - The fact that the proxy solicitor was simultaneously soliciting votes on behalf of management and recording shareholders' voting instructions created potential conflicts of interest and confusion.
- *Lack of prior disclosure* - Given the limited and relatively new use of the system in Canada, the lack of specific disclosure regarding TeleVote was "surprising" and, while shareholders might reasonably expect to be contacted by phone, there is a significant difference between proxy solicitation and vote taking.
- *Lack of sufficient safeguards* - The TeleVote system lacked sufficient checks and balances to ensure that votes were taken in a manner that allowed the shareholder to make his or her choices privately, on a fully informed basis and without undue pressure

from a proxy solicitor. On this point, the court noted that a proper system "may involve a system that allows the operator to transfer callers to an automated system where they can place their votes privately using their unique identifiers, or at least some kind of immediate and independent confirmation, perhaps by email, of the shareholder's identity and the votes taken".

- *Imbalance* - The TeleVote system gave Mosquito an unfair advantage over the dissident group, who were limited to the traditional paper, telephone and internet processes.

In concluding that the breach of the dissident group's expectation was "oppressive" or "unfairly prejudicial", the court found that Mosquito, in authorizing the use of TeleVote in these circumstances, and the meeting Chair, in allowing the votes taken by TeleVote to be counted (notwithstanding no evidence of any *mala fides* on the Chair's part), failed to act fairly, and that this, in combination with the other voting irregularities, constituted oppressive and unfairly prejudicial conduct that affected the dissident group's right to a "fair and transparent voting process at the AGM". The court determined that it was appropriate to set aside the AGM and declare it, and all resolutions passed at it, invalid and require Mosquito to reconvene a meeting of its shareholders at which, among other things, TeleVote would not be used.

Implications

The *Mosquito* case emphasizes the importance of following voting procedures that are clearly described, disclosed in advance and contain sufficient safeguards to ensure that their operation is consistent with the safeguards contemplated by applicable regulation and reflected in general practice, particularly in contested meetings.

While the use of TeleVote was rejected in this case, the court also noted that TeleVote is relatively new and encouraged the industry to take steps to establish appropriate protocols for its use, particularly in contested meetings, and indicated a belief that such systems will become widely used to facilitate shareholder meetings.

Please contact any member of our Corporate Securities Group to discuss the implications of this decision.