BY NEILL MAY

Shareholder democracy in Canada

Democracy is not easy. Not a tremendous insight on my part, and typically inelegantly expressed, but fairly indisputable. The statement is truer still in relation to shareholder democracy, which adds complications such as trading of voting rights, questions as to whether those exercising voting power should have responsibility to act not only in their own best interests but in the interests of others, and uncertainty as to who holds the right to vote. In this regard, a far more eloquent commentator's observation about democracy is aptly applied to shareholder voting — Oscar Wilde noted, "Democracy is simply the bludgeoning of the people, by the people, for the people."

Shareholder activism is the focus of much public attention lately, both high-profile corporate disputes (such as the pressure exerted by David Einhorn of Greenlight Capital to have Apple distribute some of its cash, and the proxy contests on both sides of the border including, in Canada, battles over Rona, CP, and others) and in policy debate. At the core of the policy debate is whether shareholder activism is a positive force. Many argue activists can unlock value, that even by their existence they exert discipline on management of public issuers, and unlike cases where public issuers are taken private, the benefits of the value created by activists continue to be enjoyed by public shareholders. Contrary views claim activists' objectives are not always aligned with those of the company or other stakeholders, activists are often focused on the short-term at the expense of a company's future, and their intervention can be disruptive. The pressure on Apple elicited a scathing response from the venerable Martin Lipton, who called Greenlight's purported focus on short-term rewards "a clarion call for effective action to deal with the misuse of shareholder power."

There is no simple answer to whether shareholder activism is a good thing. There are circumstances where activism has generated value and others where it has not. The complexity and intensity of the debate is daunting, which may have been part of what Winston Churchill meant when he said, "The best argument against democracy is a five-minute conversation with the average voter."

There is an old joke about how a physicist, a chemist, and an economist stranded on a deserted island with only canned food propose to solve their problem. The economist's solution: "Why don't we just assume we have a can opener?" Playing an economist, I am going to assume activism can have both positive and negative consequences in different cases, and move on to question whether the regulatory framework creates a proper balance. Put differently, is there some reason inherent in our rules that has made Canada, in the words of a *Globe & Mail* columnist, "a promised land for activist shareholders?"

To be sure, there are differences between Canadian and American rules. Identifying those deviations in isolation, however, is dangerous, because our whole framework is different, including rules governing reporting, the framework for calling and holding shareholder meetings, and how we deal with changes of control generally. The systems evolved differently, from different starting points and subject to different stimuli. In Canada, issuers are generally smaller, the country is smaller, and the culture is less litigious. Care must be taken, therefore, in analyzing particular elements of the system out of context.

Having said that, the Canadian framework is, in some ways, conducive to activism. A shareholder can call a meeting if it owns a threshold percentage of the shares (five per cent in most cases), and the threshold for shareholders to publicly disclose their holdings is at 10 per cent (compared to five per cent in the U.S.). A shareholder can solicit proxies from up to 15 shareholders without the requirement to do a proxy circular, and we don't allow classified boards (under which only a portion of the board is up for election in a given year). These structural elements, combined with growing institutional ownership of Canadian issuers and institutional investors' growing comfort in supporting public exercises of activist pressure, have made Canada a relatively hospitable environment for proxy contests.

That is not to say the balance is tilted entirely in favour of dissident shareholders. Corporations maintain a number of significant levers, including some control over the timing of meetings, as well as power over the proxy processes and the conduct of meetings. Additionally, new tools are being developed for corporations, such as "advance notice bylaws," which remove the potential for an ambush at a shareholder meeting by requiring advance notice of board nominees.

The irony is virtually all these rules were created long before the rise of shareholder activism, and scientifically assessing whether they achieve the proper balance will only be possible after there have been more contests.

In the meantime, I will entertain myself with additional quotes (honestly, this used to be a great party trick, but I'm less useful in this regard since the invention of the Internet). To paraphrase Winston Churchill, democracy is the worst system in the world, except for all of the others. That perspective just gets us over the hump in the context of shareholder voting rights; democracy has been embraced, we just need to settle the rules. CL

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