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Proxy Access in Canada: An Opportunity for Innovation

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Canada has long been regarded as one of the most activist friendly jurisdictions in the world. Our corporate and securities legislation contains several features designed to allow shareholders to bring about changes to the companies they own.

Unfortunately, as a practical matter, these rights are not always as effective as our leg-

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Under the Threshold

Blackhawk (HAWK): JANA; CitiTrends (CTRN): Macellum; Deckers (DECK): Red Mountain; DigitalGlobe (DGI): Edenbrook; General Motors (GM): Greenlight; On Deck (ONDK): Marathon; PrivateBancorp (PVTB): Third Point; Tangoe (TNGO): Engine/Ancora; Universal Health (UHS): CtW; Vishay (VPG): Ancora; AIG Inc. (AIG): Carl Icahn; Air Methods (AIRM): Voce; ClubCorp (MYCC): FrontFour; General Electric (GE): Trian; Innoviva (INVA): Sarissa Capital; Kate Spade (KATE): Caerus; Rockwell Collins (COL): Starboard Value

NEW

On March 16, 2017, **Blackhawk Network Holdings Inc. (HAWK)** and **JANA Partners** (4.7%) entered into a Cooperation Agreement, pursuant to which Blackhawk agreed to (i) expand the Board from eleven to thirteen directors and appoint Robert Henske and Jeffrey Fox to the Board and (ii) form a cost savings

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Around the World

Azko Nobel: Elliott Management; French Connection: Gatemore Capital; Bowleven: Crown Ocean; GAM: RBR Capital; John Menzies: Shareholder Value Management; Johnston Press: Crystal Amber; Safran: TCI Fund; Samsung: Elliott Management

NEW

On March 22, 2017, **Elliott Management** (~3%) announced that it is pushing **Akzo Nobel NV** to engage with PPG Industries Inc. (PPG) regarding PPG's bid to acquire Akzo, initially for €83-a-share and most recently €88.72 a share, an action that Causeway Capital Management LLC (6.8%) supports. Akzo rejected both offers, stating that both offers undervalue the Company and do not merit

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10 Questions with David Lorber

David Lorber is a co-founder and Portfolio Manager of FrontFour Capital Group LLC and a co-founder and Principal of FrontFour Capital Corp. Mr. Lorber has worked with numerous corporate boards and executives to restructure both operations and balance sheets, implement corporate action and governance policy changes. Earlier in his career Mr. Lorber was a Senior Investment Analyst at Pirate Capital LLC, an Analyst at Vantis Capital Management LLC, and an Associate at Cushman & Wakefield, Inc.

13DM: FrontFour runs successful activist engagements in the U.S. and in Canada. Tell us a little about FrontFour and your investment philosophy, particularly with respect to activism.

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islators may have intended. For example, proxy access – a shareholder's right to make proposals via the company's proxy materials - has long been enshrined in Canadian corporate law. Although proxy access is intended to make it easier for a shareholder to bring about changes in the boardroom by avoiding the time and expense involved in preparing and mailing a dissident proxy circular, it is rarely used, particularly to replace incumbent directors. This is due, in large part, to the significant limitations associated with this right, which make it difficult to use effectively in the real world.

Recognizing this deficiency, in May 2015 the Canadian Coalition for Good Governance (CCGG) published a policy paper offering a number of suggestions as to how proxy access in Canada could be reformed to be a more effective tool for shareholders. The CCGG's suggestions mirrored a rising trend of U.S. companies voluntarily adopting proxy access in response to pressure from large institutional shareholders (faint echoes of this trend are starting to be heard in Canada – in the 2017 proxy season, two Canadian banks received shareholder proposals requesting a form of proxy access that is similar in some respects to the version that is being adopted in the U.S.). At the same time, the CCGG's suggestions would eliminate some of the statutory rights currently available to shareholders. It is in this context that we will examine the Canadian proxy access system, the U.S. experience and the CCGG's proposed reforms to consider the most effective and innovative method of modernizing proxy access in Canada.

The Current State of Proxy Access in Canada

Proxy access allows shareholders to use the company's annual proxy materials as a platform to submit proposals on a variety of matters to their fellow owners for consideration. Shareholders who satisfy certain conditions may use proxy access to submit a proposal for the election of directors that they select for inclusion in management's proxy circular and proxy form. This ought to provide a relatively easy and effective way for shareholders who are not satisfied with some or all of the incumbent directors to put forward competing candidates. In practice, the way proxy access rights currently operate in Canada make them largely ineffective for that purpose.

Proxy access rules in Canada generally allow shareholders who hold at least 1% of a corporation's outstanding voting shares (or shares whose fair market value is at least $2,000) to submit a proposal advocating for the election of director nominees specified by the shareholder. At least one of the shareholders submitting the proposal must have held its shares for six months or more and the proposal must be signed by one or more holders of shares representing at least 5% of shares entitled to vote at the meeting at which the proposal is being presented. Shareholders are not limited in the number of nominees they can put forward; they can propose anywhere from one nominee to a number that would replace the entire board.

While the bar for making a shareholder proposal is relatively low, the right is subject to a number of limitations that significantly diminish its utility for shareholders, including:

• an incumbent board's ability to reject shareholder proposals on a number of grounds, including if it determines the proposal (i) has been submitted with the primary purpose of "enforcing a personal claim or grievance" against the corporation or its directors or officers, (ii) is being used to "secure publicity" or (iii) "does not relate in a significant way to the business or affairs of the corporation";

• a requirement that shareholder proposals must be submitted to the corporation at least 60 to 90 days (depending on the jurisdiction) before the anniversary date of the notice of meeting sent to shareholders in connection with the previous annual meeting; and

• a very limited opportunity for the proposing shareholder to advocate effectively for its proposal in the circular because of (i) a 500-word limit on the length of the proposal and any corresponding statement of support and (ii) the lack of any requirements around how the proposal must be included in the proxy circular (meaning that management could bury the proposal in the circular such that it is easy to miss).

Current proxy solicitation rules in Canada also place shareholders who wish to rely on proxy access at a tactical disadvantage. Even if a shareholder successfully uses proxy access to propose dissident nominees, proxy solicitation rules in Canada provide that they may not broadly solicit shareholders without filing a dissident proxy circular. Although shareholders in this position could still use exceptions to the broad solicitation rules and advocate their position through public broadcasts (such as press releases) or "quietly solicit" up to fifteen shareholders, they would not be able to target shareholders through an all-out proxy campaign without filing and mailing a dissident proxy circular. In most circumstances, this will significantly reduce the likelihood that a dissident shareholder will succeed in having its nominees elected, as the incumbent board will likely run a broad solicitation of all shareholders in support of their re-election. If a shareholder cannot broadly solicit proxies without filing and mailing a dissident circular, proxy access has limited utility.

The U.S. Experience

Unlike the long-standing statutory proxy access rules in Canada, proxy access has never been a feature of corporate law in the U.S. After a number of failed attempts to mandate a broad proxy access regime -

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most recently in 2010 - the Securities and Exchange Commission (SEC) determined that corporations should be left to decide how to implement proxy access provisions individually and what features to include. The rule proposed by the SEC in 2010 would have allowed shareholders holding at least 3% of a corporation's outstanding shares for three years to include director nominees comprising up to 25% of a corporation's board in company proxy materials. A federal appeals court vacated the rule on the basis that it was "arbitrary and capricious." The court noted that the SEC failed to "adequately assess the economic effects" of broad implementation of proxy access but did not find proxy access rules unconstitutional. It therefore left open the possibility of a regime developing organically via shareholder resolutions but provided a significant blow to the SEC's ability to mandate proxy access in the U.S.

In late 2014, a number of New York-based pension funds and corporate governance advocacy groups led by the New York City Comptroller launched the Boardroom Accountability Project - a non-binding proxy access shareholder resolution campaign. In conjunction with major institutional investors, the campaign submitted proxy access shareholder proposals simultaneously to 75 companies (the "NYCC 75") targeted for their concerning corporate governance practices. This movement was the tipping point for proxy access in shareholder proposals in the U.S. During the 2015 proxy season, over 80% of the original NYCC 75 adopted proxy access in their by-laws and proxy access was the highest-profile shareholder proposal topic.

Faced with substantial shareholder support for proxy access, many other U.S. companies have adopted proxy access policies. According to the Council of Institutional Investors and Shearman & Sterling LLP, as of early 2017, approximately 350 U.S. corporations have added some form of proxy access to their by-laws, including almost 70% of the 100 largest U.S. public companies, about half of the S&P 500, about 40% of the Fortune 500 and 11% of the Russell 3000 (constituting more than half of the index's market capitalization). Although there are some differences in how each company codifies proxy access, the majority of proxy access by-laws tend to share similar characteristics colloquially known as '3-3-20-20' rights. This means that up to twenty shareholders who have in the aggregate held 3% of a corporation's shares for three or more years may nominate up to 20% of the board's candidates for inclusion in the corporation's proxy materials. In addition to the 3-3-20-20 rights, almost all proxy access by-laws contain limitations on nominations made with intent to change control of a company's board. By limiting proxy access to only those shareholders who are seeking to nominate a limited number of directors and have held their shares for a relatively long period of time, U.S.-style proxy access seeks to balance shareholders' interests in having a relatively easy and effective tool for making proposals and corporations' interests in ensuring that they are not continually inundated with potentially spurious proposals from small or short-term owners.

CCGG's Proposal to Fix Proxy Access

Recognizing the limitations of proxy access in Canada in its current form, the CCGG released a policy paper in May 2015 advocating significant changes. Borrowing heavily from the U.S. experience, the CCGG proposed a number of recommended changes to the proxy access regime to be set out in the Canada Business Corporations Act (CBCA).

The CCGG proxy access proposal includes the following key elements:

• maintaining the support threshold for making shareholder proposals with respect to the election of directors at 5% for companies with a market capitalization of $1 billion or less, and reducing it to 3% for companies with a market capitalization over $1 billion;

• requiring that shareholder proposals and supporting statements included in the management proxy circular be represented equally with management nominees in both length and location;

• permitting broad solicitation by dissident shareholders with respect to the election of candidates proposed via proxy access, with the company required to pay the shareholder's reasonable solicitation costs;

• limiting the number of directors a shareholder may nominate to the lesser of three or 20% of the board; and

• requiring "nominating shareholders" to represent that they are not seeking control of the issuer in any capacity.

Surprisingly, the CCGG proposal does not require any minimum hold period as a prerequisite for submitting shareholder proposals. This omission is a significant departure from the American 3-3-20-20 proxy access model and the existing Canadian regime.

This proposal both gives and takes from the current proxy access mechanism. Though it seeks to balance the proxy system by giving shareholders more ready access to the company's proxy materials and the ability to broadly solicit proxies in favor of the proposals, it also takes a number of unnecessary steps backwards. First, by removing the hold period, the CCGG's proposal makes proxy access too easy. Second, by limiting the number of directors that may be replaced via proxy access nominations, the proposal significantly undermines its utility as a tool for shareholders who wish to make wholesale changes to the board. A more effective proxy access regime would impose more discipline on shareholders wishing to initiate a process that can be significantly disruptive and costly for the company and fewer limits on the ability of shareholders who have demonstrated a sustained inter-

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est in a company to contest the election of as many (or as few) incumbent directors as they think appropriate.

Time for Innovation: A Proposal for Modernizing Proxy Access

The CCGG has the right idea – giving shareholders a more effective tool for accessing a company's proxy materials - and, in many ways, set out a useful path forward.

Unfortunately, the proposals:

• do not go far enough, to the extent they adopt the U.S. 3-3-20-20 model with respect to limits placed on the number of directors shareholders can nominate via proxy access; and

• go too far, to the extent they ignore the U.S. 3-3-20-20 model (and the existing Canadian rules) and neglect to include any hold period requirement that shareholders must satisfy before they are allowed to access the company's proxy materials.

We believe that proxy access reform in Canada should start with the current regime and add certain features, including some aspects of the CCGG proposals. The objective is to turn proxy access into a useful, affordable and accessible right that long-term shareholders can and will actually use to successfully nominate candidates for election without becoming unduly disruptive to companies.

Ownership Thresholds and Hold Periods Are Appropriate

Proxy access reform should balance the interests of shareholders and those of issuers. Without reasonable limits on its use, the relatively low cost (to shareholders) of proxy access could result in companies being continually inundated with proposals from small or short-term shareholders who may or may not have genuine long-term concerns. Responding to shareholder proposals can be time consuming, expensive and distract the incumbent board and management from other matters; providing all shareholders with unfettered access to proxy materials would therefore be counterproductive.

Minimum ownership thresholds and hold periods are two important ways of imposing discipline on shareholders' use of proxy access. We believe that the existing Canadian proxy access rules largely get it right on these two issues.

Requiring shareholders to own some reasonably meaningful stake in a company before they can use proxy access is sensible. All of the iterations of proxy access considered above (the existing Canadian rules, the U.S. 3-3-20-20 model and the CCGG proposal) include a minimum ownership threshold. This feature should be retained in any kind of proxy access reform proposal and, in our view, the existing CBCA threshold (1% ownership with 5% shareholder support for proposals involving the election of directors) is appropriate given the relatively small size of the average reporting issuer in Canada. While there is some appeal to the CCGG's idea of a lower threshold for larger companies, we believe that (i) the number of cases in which this bifurcated approach will have any practical consequence is quite low and (ii) there are some potential complexities associated with the CCGG's proposal that could require further refinements (e.g., should the $1 billion threshold be adjusted over time, would the bifurcated approach apply to private companies and, if so, how is market capitalization calculated in those circumstances, etc.). We would therefore favor a simpler approach of retaining the existing minimum ownership requirement under the CBCA.

Similarly, we believe that requiring some kind of minimum ownership period before a shareholder may submit a proposal is appropriate and helps to ensure that proxy access does not become a tool that is used by shareholders looking to advance short-term interests. The CCGG proposal is at odds with existing Canadian proxy access requirements (six-month hold period) and the U.S. 3-3-20-20 model (three-year hold period) and should not be adopted. We believe that eliminating the hold period requirement could result in proxy access being used opportunistically by activists seeking to disrupt incumbent boards in the interests of advancing short-term strategies. Furthermore, a hold period helps to ensure that a shareholder will have had an opportunity to fully familiarize itself with the company and its strategy before it is afforded a relatively easy avenue means of engaging in a proxy contest. If, during the hold period, a shareholder has concerns that it wishes to address, it can always seek to engage in a dialogue with the incumbent board or, if its concerns are so pressing that it cannot wait for the hold period to expire, launch a proxy contest the 'traditional' way by filing a dissident proxy circular.

Therefore, while a mandatory hold period may mean that some shareholders who have legitimate concerns about a company's affairs cannot immediately use proxy access as a tool to address those concerns, this potential downside is outweighed by the benefits of making the system less prone to abuse and encouraging discussions between an unhappy shareholder and an incumbent board before the dispute escalates into a formal process to replace directors. However, we believe that the three-year hold period mandated by the typical U.S. proxy access model is excessive and will likely serve as a significant impediment to the use of proxy access. On the other hand, the CBCA six-month hold period is probably not long enough. We suggest that a one-year hold period strikes an appropriate balance and should be adopted in Canada.

Proxy Access Should Provide Shareholders Unrestricted Nomination Rights

Currently, one of the main differences between proxy access in Canada and the U.S. is the absence of any limits on the number of directors a shareholder of a Canadian company may seek to nominate via a shareholder proposal.

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The CCGG's proposal seeks to align Canadian proxy access with the U.S. model by limiting the number of directors a shareholder may nominate to the lesser of three or 20% of the board. The CCGG's rationale for this change is that it avoids "creeping board control." However, the CCGG's proposal does not provide any further rationale for why creeping board control is potentially problematic or why the CCGG believes the particular limit on nominations it has suggested is an appropriate response to that concern. Imposing a cap on the number of directors who may be nominated via a shareholder proposal seems to undermine the goal of making proxy access a more effective tool for shareholders.

Creating Equal Opportunity in Proxy Materials and the Solicitation Process

Two of the primary reasons proxy access is rarely, if ever, used in Canada are (i) the absence of any meaningful fair disclosure requirements vis-à-vis proxy proposals and (ii) restrictions on soliciting proxies in favor of a proposal without filing a dissident proxy circular. We believe that these two practical restraints must be removed from the proxy access regime to make it a truly useful tool for shareholders.

We agree with the CCGG's proposal as it pertains to fair disclosure in management's proxy circular and solicitation. The CCGG suggests that shareholder nominees be placed in the same location in the proxy circular and form of proxy as the company nominees and that the same opportunity to present information on nominees' background and qualifications is available for all nominees. In addition, any relevant information regarding shareholder nominees, including compensation packages or voting arrangements should be disclosed by both management and dissidents so as to provide shareholders with a complete picture of the nominees.

In addition to the changes set out in the CCGG proposal, we also believe that shareholders:

• should have the right to include a more substantial statement of support in favor of a proposal – a limit of 5,000 words (instead of the current 500-word limit) would provide a more meaningful opportunity for shareholders to present arguments in favor of a proposal; and

• should be required to provide, as part of a proposal, all information regarding the shareholder and any nominees being put forward by the shareholder that would be required to be included in a dissident proxy circular (and such information should have to be included in the company's proxy circular) – this ensures that the company and all other shareholders will have access to the same kind of information about the nominating shareholder and its nominees as they would in a 'traditional' proxy contest (and facilitates proxy solicitation by the shareholder, as described below).

We also agree with the CCGG's recommendation that shareholders using proxy access to make a proposal should be allowed to engage in broad proxy solicitation in favor of the proposal. Whether the shareholder's proposal is disseminated through management's proxy circular or its own dissident proxy circular, the effect is the same – the proposal is distributed to the corporation's shareholders as the dissident position. As the law currently stands, if a shareholder has a proposal accepted and distributed in a management proxy circular, it cannot engage in any solicitation unless it files and mails its own dissident proxy circular subject to the public broadcast and private solicitation exceptions. If shareholders cannot broadly advocate for their own positions, their chance of success is limited. To address this imbalance, proxy access should come with the right of broad solicitation provided that the proxy circular contains appropriate disclosure regarding the shareholder making the proposal and its nominees.

Unlike the CCGG, we believe that reasonable solicitation costs, beyond those directly related to the distribution of the management circular and form of proxy, should be borne by the shareholder rather than the corporation (particularly if broad solicitation rights are included in the proxy access reform 'package'); a shareholder should be prepared to bear the cost of advocating for its position (and we expect that allocating solicitation costs in this manner will help impose some discipline on the use of proxy access as a way of running a dissident proxy campaign). If shareholders are successful in putting their nominees on the board, some form of expense reimbursement would be appropriate if it were approved by disinterested shareholders at the shareholder meeting.

Removing Barriers to Entry

Finally, we believe that the current legislative exemptions that allow corporations to exclude shareholder proposals from the management circular should be clarified and amended. For example, an incumbent board may exclude a shareholder proposal from its proxy circular if the proposal has been submitted with the primary purpose of "enforcing a personal claim or grievance" against the corporation or its directors or officers. While we believe that shareholders should not receive carte blanche acceptance of their proposals, incumbent boards should only be able to reject a shareholder proposal in clear, specific circumstances. We would support amending the applicable statutes to provide greater clarity to help guide both shareholders and corporations to better understand the circumstances where they may rely upon or be susceptible to these exemptions.

Conclusion

Proxy access in Canada is an important shareholder right that is need of innovation. Though the CCGG proposals and the

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U.S. 3-3-20-20 model provide interesting examples of how proxy access could be modernized and refined in Canada, we believe that proxy access reform should start with, and build upon, the existing regime. We also believe that it would be preferable for proxy access reform to be implemented in a coordinated and uniform manner (via legislation) as opposed to the voluntary adoption approach emerging in the U.S., which risks creating a patchwork of standards that can potentially vary from company to company and are not necessarily aimed at making proxy access as effective as it should be.

Therefore, we support proxy access rules that

• retain the existing 1% ownership and 5% support requirements for shareholders who wish to use proxy access to nominate individuals for election to a corporation's board of directors;

• retain the existing requirement of a minimum hold period before shareholders are able to use proxy access, although we would increase the hold period to one year from the current six months;

• do not impose any limitations on the number of incumbent directors a shareholder may seek to replace via proxy access;

• ensure that shareholder proposals are given equal and fair prominence in the company's information circular and that shareholders are given a reasonable opportunity to 'make the case' for their proposals;

• allow shareholders to broadly solicit proxies in favor of their proposals on the basis of appropriate disclosure in the company's information circular; and

• provide greater clarity as to when an incumbent board can reject a proposal based on the rationale that it is "enforcing a personal claim or grievance," "being used to secure publicity," or "does not relate in a significant way to the business or affairs of the corporation".

We acknowledge that a number of the changes that we support would require amendments to Canadian corporate and securities laws. While changing legislation (particularly corporate law statutes) is not easy, that is not a reason that proxy access reform should not be pursued.

Proxy access is a powerful mechanism shareholders can use to exert influence and effect change to boards; but its current form makes it an ineffective tool. By working with the current system and learning from the U.S. experience along with the CCGG proposal, Canada can make a number of innovative changes that will enable it to develop a state of the art proxy access regime that carefully balances long-term shareholder interests with company interests.