

Securities Law Update

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Alberta Securities Commission Weighs In On Use of Soliciting Dealer Arrangement in Proxy Contest

The Alberta Securities Commission (ASC), in *Re PointNorth Capital Inc.*, recently declined to exercise its public interest jurisdiction to terminate a “soliciting dealer arrangement” used by a TSX-listed company (Liquor Stores N.A.) to solicit proxies in favour of the company’s director nominees during a proxy contest. The decision is notable because it is the first time a Canadian securities regulator has been asked to intervene in such an arrangement in the context of a proxy contest.

Soliciting Dealer Arrangements

A soliciting dealer arrangement involves a company agreeing to pay a group of brokers a cash commission for soliciting their clients to either tender to a bid or vote in favour of a transaction or other matter. This longstanding practice originated in the context of take-over bids and over the course of the past decade had migrated to voting transactions, such as going private transactions implemented by plans of arrangement. More recently, these arrangements have been adopted by companies during proxy contests, whereby the company agrees to pay brokers for votes *in favour* of the company’s director nominees. The implementation of a soliciting dealer arrangement by Agrium Corporation during the proxy contest initiated by JANA Partners LLC is the most prominent example of this practice, and generated intense scrutiny from many market participants. To date, there have been no examples of dissident shareholders adopting this practice. Notably, the use of soliciting dealer groups in soliciting votes is non-existent in the U.S., where brokers

have generally concluded that accepting compensation for soliciting votes from their clients would be inconsistent with their fiduciary duties to their clients.

Background

In 2017, PointNorth, a significant shareholder of Liquor Stores, commenced a formal proxy contest to obtain control of Liquor Stores’ board. During the course of the proxy contest, Liquor Stores implemented a soliciting dealer arrangement for the stated purpose of allowing the company to communicate with the substantial number of its retail shareholders who, in accordance with applicable regulations, had declined to provide their contact information to the company and could therefore only be contacted by their brokers. Under the terms of this particular arrangement, brokers would only receive compensation for proxies voted in favour of management nominees. Liquor Stores defended this structure on the basis that assisting the dissident group was not in the best interests of Liquor Store or its shareholders, given the board’s conclusion that the election of PointNorth’s nominees would destroy shareholder value. PointNorth, on the other hand, argued that this one-sided compensation structure created a conflict that impacted the advice brokers provided to their clients and was tantamount to “vote buying.”

PointNorth acknowledged that the use of soliciting dealer arrangements was not technically prohibited under Alberta’s securities laws (similar to all other Canadian jurisdictions). Accordingly, PointNorth asked the ASC to intervene on the basis that Liquor Stores’ soliciting dealer arrangement was contrary to the “public interest”. The ASC – like other Canadian securities regulators – has a broad overarching jurisdiction to sanction conduct that it determines is contrary to the public interest, even in the absence of a breach of securities laws.

The ASC's Decision

The ASC concluded, on the facts of this particular case, that it was not appropriate for the ASC to intervene on public interest grounds. In doing so, the ASC:

- applied the most stringent test, which requires an applicant to demonstrate conduct that is “clearly abusive” of investors or the integrity of the capital markets, for determining whether conduct that does not constitute a breach of Alberta’s securities laws is nonetheless contrary to the public interest;
- rejected the notion that soliciting dealer arrangements are inherently abusive of investors or the capital markets, absent evidence (which the ASC determined was not present in this case) that the arrangement in question actually impacted the advice provided by brokers to their clients or otherwise actually harmed investors; and
- relied to some degree on the fact that Canadian securities regulators have not, to date, prohibited (or otherwise regulated) the use of soliciting dealer arrangements, in proxy contests or otherwise, despite significant attention on their use in recent years.

In summary, the ASC’s decision appears to be based primarily on its conclusion that there was insufficient evidence in the record before it of the impact of this particular soliciting dealer arrangement to satisfy the stringent test applied by the ASC in this case.

The ASC noted that it did not consider potential corporate law issues, such as whether the use of a soliciting dealer arrangement in a proxy contest may be inconsistent with the fiduciary duties of the directors or oppressive (in the sense of unfairly violating shareholders’ reasonable expectation about how the company would conduct the proxy contest). Such issues would need to be adjudicated by the courts, which have historically been more deferential to the business judgement of directors than securities regulators.

Conclusion

The fact that a soliciting dealer arrangement implemented during a proxy contest has now been upheld by a Canadian securities regulator is a notable development. At the same time, the fact-specific nature of the decision, as well as the fact that the ASC declined to establish any broader principles applicable to soliciting dealer arrangements generally, suggest that it may not be the last word on the practice in Canada. Many market participants have publicly voiced strong opposition to these arrangements, particularly during proxy contests, leading some to conclude that Canada is not as “activist friendly” as is often suggested. Canadian securities regulators have recently been increasing their focus on the conduct of proxy contests, and have demonstrated a willingness to intervene in appropriate circumstances. Finally, there has been some perceived variation in the manner in which certain Canadian securities regulators apply their broad and discretionary public interest jurisdiction in various contexts. All of these factors suggest that a Canadian securities regulator could – either through proactive policy development or intervention on public interest grounds – take steps to regulate or curtail the use of soliciting dealer arrangements in the future.

For further information relating to this bulletin, please contact any member of our Securities Law Group.