

BANKING ON CORPORATE

BY NEILL MAY



Drawing lines in circles

Who doesn't miss the simple priorities and perspectives of childhood? The question of where to draw a line was much simpler with a crayon in hand. The onset of adulthood complicates that question, with queries about whether to draw at all, who should make the decision, and what are the possible consequences, to list just a few. A Socratic question about where to draw a line can provoke a thorough debate, and identify exceptions and fact patterns that challenge instinctive conclusions, but while all of that is going on the kid with the crayon in the corner can draw a lot of lines.

A number of recent Canadian proxy contests have raised questions as to whether to draw a line, and where. The issue arises because of the nature of share ownership in this country. Most shares (and other securities) in Canadian issuers are not registered in the name of the beneficial holder in the records of the issuer, but instead are held in unregistered form. Those securities are typically held through intermediaries, such as the investors' brokers. Those unregistered shareholders have the right to elect whether their identities can be disclosed to the issuer (many choose non-disclosure), and can also elect not to receive disclosure materials prepared by the issuer. Consequently, issuers are generally unable to identify, or communicate directly with, a significant portion of their security holder base. In a closely contested proxy contest reaching that anonymous segment of an issuer's security holder population can be a determinative gambit.

What has happened in some recent proxy campaigns is issuers have paid intermediaries (brokers) for votes they are able to get from their shareholder

clients, subject to the condition, in some cases, that the votes are in the issuer's board's favour, and in other cases that the outcome of the vote is favourable (from the issuer's perspective).

Supporters of the practice argue incumbent boards challenged in a proxy contest invariably spend company resources in an effort to facilitate the election of the issuer's nominees, and therefore the payments to brokers for getting supportive votes cast are nothing new. Presumably the board has determined in those circumstances that the election of the issuer's nominees is in the issuer's best interests, and so the principals of the issuer are duty bound to take steps to further those best interests. Furthermore, the argument goes, the practice is legal, results in increased security holder engagement (by tending to increase the proportion of security holders that actually vote, and participate in the process), and is something dissident security holders are equally free to do if they so choose. Supporters of the practice also argue if dissident security holders are unhappy with the practice, they are free to voice their views and if voting security holders are convinced the payments are improper then they may have the opposite of their intended effect.

Critics of the practice are skeptical of the benefits. For example, if security holder engagement is the objective, this could be achieved through a similar construct, such as paying brokers to get out the vote without tying the compensation to the way votes are cast (or to the outcome of the vote). The discipline of public disclosure, namely that issuers engaging in the practice bear the risk of security holder unhappiness with it, may, it is argued, be weak because the practice is often not clearly visible to the security holder population, or if it is visible is often not seen until very

late in the process. But most of the arguments against are more general, essentially suggesting the practice is "inappropriate"; it's like the well-known U.S. Supreme Court test for obscenity, the scientific "I know it when I see it."

Deciding whether the practice is "improper" or "inappropriate" requires one of those assessments as to whether it crosses the line. The analogy that leaps to mind, though far from perfect, is that of an incumbent government using public funds to finance negative ads about political opponents. One's views tend to be coloured by one's political biases. Being a professional advocate, of course, my perspective on the practice can be influenced by the views of my client in a given contest.

What is clear is the issue raises deeper, difficult questions about the system itself, how it is there are so many security holders distanced from the corporate democratic process, and how some brokers charged with protecting their clients' interests seem to only roll into action when compensated to direct an outcome.

As this column evidences, I have my own difficulties drawing lines. I try, but they often come out as circles (which counts, for a securities lawyer, as artistic expression). I take comfort in the fact lines are complex; I think the best way to think about this is reflected in the comedian Steven Wright's description of Salvador Dali going fishing, where he said that Dali fished with a dotted line and so only caught every other fish. How's that for a line? ☐

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