THE ACTIVIST REPORT

13D Monitor

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Proxy Contests in Canada: What U.S. Investors Need to Know

Michael Partridge and Jon Feldman, Goodmans LLP

In April 2015, FrontFour Capital Group LLC announced its intention to nominate three new directors for election at the 2015 annual general meeting of Legacy Oil + Gas Inc., an intermediate oil and gas producer based in Calgary, Alberta and listed on the Toronto Stock Exchange. On May 26, 2015, Legacy agreed to be acquired by Crescent Point Energy Corp. at a price that represented a 36% premium over Legacy's stock price before FrontFour's announcement.

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Under the Threshold

NEW

On June 15, 2015, **Barington Capital Group** and **Ancora Advisors** (collectively, the "Group" – an approximate 4% owner) sent a letter to **DHI Group, Inc. (DHX)**. In the letter, the Group urged the Board to engage an investment

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Around the World

NEW

On June 28, 2015, it was revealed through a disclosure to the French market regulator, that **Elliott Associates LP** has taken a 1.3% position in **Alcatel-Lucent**. Elliott's position is reportedly through equity swaps. This announcement

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Activism Makes for Strange Bedfellows

It has been reported that Fiat Chrysler Automobiles NV Chief Executive Sergio Marchionne has reached out to activist investors to help prod General Motors into a merger. A Company's CEO going to an activist for help is almost like Devil Anse Hatfield reaching out to Randy McCoy for a cup of sugar. In an even stranger occurrence, the Kingdom of Saudi Arabia is looking for activists as it opens its stock exchange to foreigners for the first time. The CEO of the Saudi Stock Exchange said, "These activist shareholders are basically there to allow us to better align with best global practices and hopefully that will accelerate our convergence to higher standards of corporate governance, investor relations, issuer disclosures and hopefully broaden and make more sophisticated our research coverage of our listed companies".

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10 Questions with Jon Pollock

ELLIOTT®

Jon Pollock is Co-Chief Investment Officer and Equity Partner of Elliott Management Corporation with responsibility for global situational investing, global trading and operations. Jon joined Elliott in 1989 as an analyst and later became a senior portfolio manager. In 1995, he opened Elliott's London office and for the next 14 years ran the firm's European and Asian businesses, opening additional offices in both Hong Kong and Tokyo. In 2009, he returned to New York to become Head of Global Situational Investing. Jon has been involved in a number of significant Elliott investments including Delphi Automotive, Lehman Brothers and Hess Corporation.

13DM: You oversee Elliott's $26 billion portfolio. How does activism fit into your overall investment strategy?

JP: There is an activist element to many of the areas in which we invest whether it's in equities, credit (stressed or distressed),

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JON POLLOCK
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rise of the acceptance of activism has been a welcome development with more and more funds welcoming the presence of an activist and more boards and management teams realizing that they are accountable for their performance.

At Elliott, we do not think of activism as an asset class but rather as a tool in value-based investing. At its heart, activism in the equity space is value-based investing whereby the vast majority of the value is in properly identifying companies with hidden value – companies that have good products or good assets that are simply not being monetized or developed appropriately. This is the value prong of our three-pronged test and where we spend the most amount of time researching and confirming our thesis that there is, in fact, value to be realized.

Though we are pleased that activism has become more broadly accepted, we believe the majority of the opportunity set is still in front of us. Companies frequently remain undermanaged and boards are often poorly engaged or equipped to deal with the issues their companies are facing. Certainly, activist funds have cropped up to address the opportunity, but we have found that complex situations where we can conduct detailed work with a long-term view remain in ready supply and we believe will for the foreseeable future.

13DM: Where they trade now, what is your favorite position in your portfolio and why?

JP: With a $26 billion book, I have a lot of favorites.

PROXY CONTESTS IN CANADA
(cont'd. from pg. 1)

This is just the most recent example of a long standing trend of U.S. activist investor involvement in Canadian companies, a trend that shows no signs of abating anytime soon. From Pershing Square's high profile success in reconstituting the board of Canadian Pacific Railway to numerous other less prominent examples, many U.S. activists have shown a real enthusiasm for investment opportunities north of the border.

While the investment thesis for taking a position in a Canadian company will generally be no different than it would be in the U.S., the legal framework that governs activist initiatives in Canada is different in a number of important ways. Some of these differences favour the investor and some of them favour the company, but it is important in any event for U.S. investors who are considering engaging in proxy contests or other activist strategies involving Canadian companies to understand the differences clearly and to tailor their strategies accordingly. This article outlines some of the most important legal issues relevant to shareholder activism in Canada.

Building a Position – Disclosure, Joint Actors and Take-Over Bids

Disclosure

Canada's "early warning" disclosure regime requires public disclosure of significant ownership positions in Canadian public companies and is similar to the 13D rules with two important differences:

- the Canadian disclosure threshold is 10%; and
- early warning disclosure (a press release followed by a securities filing) is required immediately upon crossing the disclosure threshold and the investor may not acquire any additional shares for one business day after filing its early warning report.

While the higher disclosure threshold in Canada can be a significant advantage for activist investors, its benefits are mitigated in a couple of ways. First, because Canadian public companies are, on average, significantly smaller than U.S. public companies, the aggregate amount of capital that can be invested before disclosure is required will also often be significantly lower. Second, the requirement for immediate early warning disclosure combined with the one business day trading moratorium precludes the common U.S. tactic of using the 10 day period between tripping the disclosure threshold and filing a 13D report to significantly increase the investor's position.

The early warning system also includes an alternative monthly reporting system that is available to "eligible institutional investors" (including investment managers that are registered under the U.S. Investment Advisers Act of 1940 or are exempt from registration). The principal advantage of the alternative system is that it allows for a significant delay in disclosure - within 10 days after the end of a month in which a reporting trigger has occurred rather than immediately.

An investor that intends to acquire control of an issuer may not use the alternative monthly reporting system but, at present, "activist" intentions short of the acquisition of control do not preclude an eligible institutional investor from using the alternative system. There have been some situations where investors with activist intentions have used the alternative monthly reporting system to strategically accumulate significant positions in Canadian companies (i.e., well in excess of 10%) before having to disclose those positions. Partly as a result over concerns with the propriety of those tactics, the early warning rules are expected to change later this

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PROXY CONTESTS IN CANADA (cont'd. from pg. 4)

year to, among other things, extend the prohibition on using the alternative system to investors who intend to engage in proxy contests.

Joint Actors

Canadian securities laws aggregate shares owned by "joint actors" for certain purposes, including early warning disclosure and the Canadian formal take-over bid rules. For example, if two investors who each own 6% of the outstanding shares of a Canadian public company are deemed to be joint actors, they would both required to make early warning disclosure on the basis of their collective 12% ownership position. Similarly, if joint actors collectively own more than 20% of a target's outstanding shares any acquisition of additional shares by any of the joint actors would be a take-over bid that, absent an applicable exemption, would be subject to the Canadian formal take-over bid regime. These potential consequences generally mean that joint actors must carefully monitor and coordinate their collective trading activities and disclosure.

Investors will be *presumed* to be acting jointly if they have an agreement or understanding (which need not be written) regarding the voting of a target's shares and will be *deemed* to be acting jointly if they have an agreement or understanding regarding the acquisition of a target's shares. It is not always easy to determine the point at which investors pass from merely having discussions about their respective views and intentions regarding a company to forming some kind of understanding that turns them into joint actors. Compounding the problem, the actions of investors in this regard are susceptible to being judged in hindsight based on circumstantial evidence. For example, a recent Alberta court decision found that participating in a conference call with a proxy solicitor indicated that all of the shareholders who sat in on the call were joint actors.

The uncertainties associated with when investors might be deemed to be joint actors and the potential disclosure and trading consequences that follow mean that Canadian shareholders (particularly institutional investors) can be wary of engaging with activists, presenting challenges to investors who wish to explore the potential level of interest for change amongst key shareholders or discuss their general perspectives with other investors.

Take-over Bids

Canadian securities law limits an investor's ability to acquire a 20%+ stake in a public company other than by way of a formal take-over bid (tender offer). Any offer to acquire outstanding voting or equity securities of a Canadian public company that would result in the investor (and its joint actors) owning 20% or more of the outstanding shares must proceed by way of a formal take-over bid unless an exemption is available.

There are a number exemptions that can be used to build positions in excess of 20% without having to make a take-over bid to all shareholders. The two most commonly used are:

- the *private agreement* exemption, which allows an investor to acquire any number of shares without making a formal bid provided the shares are acquired through private agreements with not more than five shareholders and at a price, including brokerage fees or commissions, not exceeding 115% of the market price; and
- the *normal course purchase exemption*, which allows an investor to acquire up to 5% of the target's outstanding shares in any 12 month period without making a formal bid by way of ordinary course trading over an exchange.

Gathering Support – Proxy Solicitation and Insider Trading Considerations

Proxy Solicitation Generally

In Canada, proxy solicitation is regulated by securities laws and, in some jurisdictions, local corporate law. Although the general approach to proxy solicitation is consistent across all jurisdictions, there can be important differences in how certain issues are handled depending on where the target company or its shareholders are located.

All jurisdictions in Canada prohibit issuers and dissident shareholders from soliciting proxies unless they have mailed a proxy circular in a prescribed form to each shareholder whose proxy is being solicited. "Solicit" is defined to include, among other things, "a request to execute or not

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PROXY CONTESTS IN CANADA (cont'd. from pg. 5)

execute a form of proxy" and "the sending of a form of proxy or other communication to a shareholder under circumstances that are reasonably calculated to result in the procurement, withholding or revocation of a proxy" but does not include, among other things, public statements by a shareholder regarding how it intends to vote and the reasons for that decision. This is very similar to the way in which solicitation is defined in Rule 14a-1 of the U.S. Securities Exchange Act of 1934 and has been broadly defined by courts to capture a wide range of activities that precede the formal proxy solicitation process. Accordingly, companies and investors must be very careful, when making public statements or communicating with shareholders in the context of potentially contested situations before mailing a proxy circular, to ensure that they not do anything that could be interpreted as facilitating or indirectly leading to the solicitation of proxies.

It is also important to remember that the definition of solicit includes activities intended to result in the withholding of proxies; therefore communications that urge shareholders to refrain from executing another party's proxy or to withhold votes from the election of certain director nominees may constitute proxy solicitation and are generally only permissible after the party making the communication has mailed a proxy circular.

Proxy Solicitation Exemptions

Canadian securities laws and most (but not all) corporate statutes contain certain exemptions from the formal proxy solicitation rules that permit a dissident shareholder (but not the issuer) to solicit proxies without mailing a proxy circular in certain circumstances.

The most commonly used exemptions are the *quiet solicitation* exemption and the *public broadcast* exemption.

Quiet Solicitation

A dissident shareholder is entitled to solicit support from not more than 15 shareholders without filing or mailing a dissident proxy circular. There are no rules as to the timing or substance of a quiet solicitation process. This exemption is frequently used by activists who wish to solicit the support of large shareholders in advance of engaging with the company or publicly announcing their intentions and can be very helpful tool in either laying the groundwork for an eventual formal proxy contest or creating a significant block of support for a private approach. Other shareholders may not always be receptive to quiet solicitation approaches due to concerns about becoming a joint actor with an activist or becoming subject to trading restrictions.

Public Broadcast

A dissident shareholder may also solicit proxies without mailing a proxy circular by way of a public broadcast, speech or publication provided the dissident has filed certain information that is required to be included in a proxy circular. This exemption can allow an activist to start waging its public relations battle in a contested situation before it is ready to commence the formal proxy solicitation process. It was most prominently used in the context of the Pershing Square / Canadian Pacific Railway proxy contest and has been employed on a number of different occasions since then including Centennial Group Limited's recent proxy campaign to replace the board of Temple Hotels Inc.

Insider Trading

Canadian insider trading laws are significantly different from the U.S. regime in a number of ways including blanket prohibitions on:

- trading by any person in a "special relationship" with the company (including 10%+ shareholders) who has knowledge of material non-public information; and
- disclosure of material non-public information by a person in a special relationship to another person (known as "tipping").

These restrictions create potential obstacles to an activist's ability to trade in the shares of a target company and to communicate freely with other shareholders in advance of publicly disclosing its intentions.

In particular, the prohibition on tipping creates uncertainties about whether a shareholder who owns 10% or more of the shares of an issuer can disclose to third parties its intention to seek changes in the composition of the company's board of directors or engage in a proxy contest. If that intention amounts to material non-public information about the company, it is not clear whether disclosing that information to another investor (i) contravenes the prohibition on tipping or (ii) might restrict the other investor from trading. As a result, the activist may be reluctant to expose itself to potential legal challenges relating to the nature of its communications with other shareholders, and other shareholders may be reluctant to place themselves in a situation where they will potentially be restricted from trading for an indefinite period of time.

Taking the Initiative – Requisitioning a Shareholder Meeting, Replacing Directors and Advance Notice

Meeting Requisitions

Canadian corporate law allows a shareholder or group of shareholders who own at least 5% of the outstanding shares of a company to requisition a special meeting for the purposes of changing the board. In most provinces, a simple majority vote is required to remove incumbents, following which new nominees can be elected in their place. This is an important legal difference between Canada and the U.S., where a shareholder's ability to convene

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meetings is usually seriously constrained by corporate law, bylaw requirements or both. This means that opportunities for activism in Canada are not necessarily tied as directly to the timing of a target company's annual general meeting as they are in the U.S. and staggered boards cannot be effectively used in Canada.

While the meeting requisition right can be a powerful tool for activists, in practice shareholders are often disappointed to find that it can be difficult to use effectively for a number of reasons, including:

- In some jurisdictions, the requisition right must be exercised by *registered* shareholders. Since activists will very rarely hold registered positions, exercising the requisition right in those jurisdictions requires either (i) converting a book based position into registered form, which takes time and can alert the target company to the activist's presence or (ii) arranging for the depositary who holds the shares on behalf of the shareholder (in Canada, CDS), which can be difficult to arrange.

- Target companies typically apply an extremely high standard of technical compliance to meeting requisitions. Any kind of technical "foot fault" in a requisition, no matter how minor, will often be seized upon by the target company as an excuse to reject the requisition as invalid. A shareholder who wishes to requisition a meeting must be prepared to challenge a potential rejection of its requisition in court, and Canadian courts have generally supported requiring a high level of technical compliance in meeting requisitions.

- Even if a shareholder submits a valid requisition, most corporate statutes require the target company to "call" the requisitioned meeting within 21 days but do not impose any specific requirements on *when* the meeting must occur. This gives the target significant flexibility in scheduling the requisitioned meeting at a time that is most advantageous for it (which in some cases has meant delays of several months) and Canadian courts have generally been prepared to defer to the target board's "business judgment" in determining whether the scheduling of a requisitioned meeting was reasonable. In many cases, if the target company's AGM is scheduled for anytime within six months or so of the date of the requisition it will be very difficult for a shareholder to force the company to hold a requisitioned meeting in advance of the AGM unless there is a compelling reason requiring it.

Therefore, a target company that is determined to resist an activist's call for a special meeting has numerous opportunities to delay or frustrate a meeting requisition. If the target board refuses to call a requisitioned meeting or picks a meeting date that involves an unreasonable delay, the requisitioning shareholder will be forced to apply to court for an order calling the meeting or forcing the meeting to be held at an earlier date and will often face an uphill battle in convincing a court that the company should be forced to hold the meeting rather than simply wait fo the AGM. The time and cost involved in pursuing those proceedings means that many Canadian proxy contests are fought at the AGM notwithstanding the meeting requisition right.

Advance Notice

Advance notice by-laws have become relatively commonplace in Canada and have been upheld by Canadian courts as a tool that, if appropriately employed, may be used by companies to regulate the process of director nominations and prevent shareholders from "ambushing" the company with nominations from the floor during a meeting. Canadian advance notice by-laws typically require that a shareholder provide notice of its intention to nominate individuals for election, together with certain information regarding the nominees and the nominating shareholder, not less than 30 days prior to the date of the meeting. Proxy advisory firms, such as ISS and Glass Lewis, publish guidelines regarding acceptable terms for advance notice by-laws and make voting recommendations to their clients based on whether proposed advance notice by-laws comply with those guidelines.

Much like meeting requisitions, target companies will usually be inclined to require strict technical compliance in advance notice submissions. However, in this context at least, courts may be somewhat more shareholder friendly – a recent decision of the Ontario Superior Court of Justice in the context of Orange Capital's proxy contest to replace the board of Partners REIT indicated that advance notice by-laws should be used only as a shield to protect management from ambush, and not as a "sword . . . to exclude nominations given on ample notice" or as a mechanism to "buy time to develop a strategy for defeating a dissident shareholder group".

Fighting the Battle - Proxy Advisors, Vote Buying, Majority Voting and the Conduct of Meetings

Proxy Advisors

Proxy advisors, principally ISS and Glass Lewis, are well established in Canada and play a similar role in the proxy solicitation process as they do in the U.S. In the context of contested meetings, proxy advisors will consider input from the company and the activist before making a recommendation, but will not provide either side with an opportunity to review or comment on a recommendation before it is released.

Canadian securities regulators have recently adopted guidelines setting out recommended practices and disclosure

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PROXY CONTESTS IN CANADA (cont'd. from pg. 7)

for proxy advisors. Proxy advisors are not required to adopt any of the recommended practices and the regulators have indicated that they will continue to monitor market developments in the proxy advisory industry and other international initiatives in order to evaluate whether the guidelines adequately address the Canadian marketplace's concerns.

Vote Buying

A controversial tactic that is occasionally used by target boards in Canada is the practice of paying soliciting dealer fees - a per share fee given to brokers and dealers for every share voted in favour of the incumbent directors. For example, during JANA Partners' high profile and highly contentious 2013 proxy contest to replace the board of Agrium Corporation, Agrium offered a soliciting dealer fee of C$0.25 per share for every share voted by Canadian retail shareholders in favour of the incumbent board, subject to all of the incumbents being re-elected. Agrium ultimately won the proxy contest but faced significant criticism for what many characterized as "vote buying".

Although paying a soliciting dealer fee in the context of a proxy contest raises a number of concerns regarding the potential conflicts of interest it creates for the target directors (not to mention the brokers and dealers who accept the fee), the practice is not prohibited under Canadian law. And, unlike their counterparts in the U.S., Canadian brokers and dealers are apparently comfortable accepting payments for the solicitation of votes from their clients. Accordingly, activist investors in Canadian companies who wish to engage in a proxy contest to reconstitute the board continue to face the prospect of the target board using corporate funds to pay soliciting dealer fees in favour of their own re-election.

Majority Voting

Majority voting has become an accepted and commonplace feature of Canadian corporate governance and is now required for all TSX listed companies. Although withhold campaigns have been rare in Canada to date, the widespread adoption of majority voting should, in theory, mean that a withhold campaign can be a viable strategy for activists who are not prepared to run a traditional proxy contest or who are perhaps precluded from doing so as a result of missing a nomination deadline under the target company's advance notice by-law.

Since majority voting policies provide that a company's board of director may refuse to accept a resignation tendered by a director who has been "defeated" by a withhold vote, it will be interesting to see how Canadian boards deal with directors who are forced to offer to resign under majority voting. For example, Quebecor Inc. recently refused to accept a resignation tendered by a director - after 71.5% of the votes cast for his election were "withhold" votes – based on the board's view that losing the director would be "unfortunate for all shareholders". Given the Canadian courts' general deference to the business judgment of target boards when it comes to matters involving shareholder activism generally (e.g., responding to meeting requisitions, the scheduling and conduct of meetings, etc.) it may be that target boards will be given relatively wide latitude to determine that accepting a resignation from a director who has been defeated in a withhold campaign would not be in the best interests of the company.

Conduct of Meetings

The company controls all aspects of how shareholder meetings are conducted. Perhaps most importantly, the target company selects the chair of the meeting and the chair typically has the power to make final decisions on all procedural matters, including disputes over the validity of proxies, enforcing (or waiving) proxy cut-off deadlines, ordering postponements or adjournments, the validity of motions from the floor, etc. In a contested meeting, these decisions can have a meaningful impact on the final result of the vote and so activist investors will often demand that the company appoint an independent chair to preside over the meeting – a demand that is almost invariably ignored. Canadian courts will generally be prepared to intervene to require the appointment of an independent chair only where it is clear that the company's proposed chair would create "a reasonable apprehension concerning the conduct of the meeting" or a "demonstrated impropriety" by the proposed chair – simply having an interest in the outcome of the meeting (e.g., being voted out as a director) or having been involved in opposing an activist investor would not generally be sufficient to justify intervention.

Another procedural consideration potentially relevant to activists is that in Canada there are no legal requirements for the issuer to give a shareholder access to proxy voting results or to review management proxies in advance of a meeting. As a result, it is often difficult for activists to have a clear picture of the voting results before they are announced at the meeting.

Given the potential importance of how a shareholder meeting is conducted, activists will often attempt to have the target company agree in advance to a mutually acceptable protocol governing various aspects of a contested meeting. These agreements can reduce the likelihood of disputes over the conduct of the meeting arising but in most cases there is usually little incentive for the company to constrain the flexibility it would otherwise have when it comes to proxy counting and meeting process issues.

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