

“Shareholder Involvement in the Director Nomination Process: Enhanced Engagement and Proxy Access”

Introduction

The Canadian Coalition for Good Governance (“CCGG” or the “Coalition”) believes that it is time for Canadian public companies to focus on enhancing “proxy access”. When CCGG refers to “proxy access” in this paper we mean the ability of shareholders to have meaningful input into the director nomination process, whether by being able to influence who the nominees are or through actually nominating directors. Under Canadian corporate law shareholders elect directors¹ but shareholders have no input in the normal course in choosing any director nominees. Current best practices in Canada suggest that those nominees should be chosen by an independent nominating committee of the board. The rise of the independent nominating committee among companies in certain sectors of the Canadian capital markets has increased the levels of independence and quality of boards of directors among those companies, most notably the larger companies on the S&P/TSX Composite Index that tend to set governance standards in Canada. The nominee slate, however, often still tends to reflect the board’s, or in some cases still the Chief Executive Officer’s, network of relationships and perspectives. Even when prospective candidates are found through the use of independent search firms, the parameters of the search firm’s mandate, as well as the acceptance of their recommendations, are determined by the directors or in some cases the CEO.

¹ This policy assumes that effective majority voting is in place, either through a company’s adoption of a policy in the form CCGG suggests in its Majority Voting Policy or as a result of a company being subject to TSX listing requirements for majority voting. CCGG has encouraged legislators to change the law to require majority voting for all public companies, including in our [comment letter](#) to Industry Canada on amending the Canada Business Corporations Act (CBCA). For a consideration of the issues surrounding majority voting please see CCGG’s [Majority Voting Policy](#).

It is CCGG's view that board composition in Canada will benefit from shareholder input into the nomination process and that such input is an essential component of shareholder democracy. This potential positive impact on boards is becoming more widely recognized. For example, an October 2014 discussion paper by the UN Principles for Responsible Investing notes "that a robust nominations process is of fundamental importance to board effectiveness, and that shareholders have an active role to play".² According to an August 2014 study by the American CFA Institute "proxy access has the potential to enhance board performance".³ Certainly board performance could use some improvement: a recent article in the *Harvard Business Review* cites a McKinsey survey of directors in 2013 which shows that even by their own measure directors are falling far short of meeting the standards expected.⁴

CCGG does not view proxy access as simply a fall-back mechanism when other attempts to improve board performance have failed; thus, it is not a means of board renewal when boards themselves fail to take the steps necessary to create a high-functioning board.⁵ Rather, CCGG believes that shareholders having meaningful input into the director nomination process is desirable in principle.

² *Director Nomination Process: Discussion Paper*, UN Principles for Responsible investment (October 2014). The Discussion Paper's Good Practices recommendations for Canada include the recommendation that "Proxy access for eligible shareholder nominations of director candidates should be in place.", page 28

³ [Proxy Access in the United States: Revisiting the Proposed SEC Rule](#), CFA Institute August 2014 (hereinafter the "CFA Institute Report")

⁴ "A mere 34% of the 772 directors surveyed by McKinsey in 2013 agreed that the boards on which they served fully comprehended their companies' strategies. Only 22% said their boards were completely aware of how their firms created value, and just 16% claimed that their boards had a strong understanding of the dynamics of their firms' industries." *Where Boards Fall Short – New data shows that most directors don't understand the company's strategy*, Dominic Barton and Mark Wiseman, *Harvard Business Review*, January - February, 2015

⁵ CCGG has long stressed the importance of board renewal and the view that the desired method of achieving board renewal is through a robust director evaluation and assessment process that is acted upon. See our [Building High Performance Boards](#), Guideline 4.

Corporate law recognizes this principle by providing shareholders with the ability to have direct input into board composition by giving shareholders the right to nominate directors from the floor at an annual general meeting (“AGM”).⁶ With our present-day widely dispersed ownership of public companies, however, attendance at the AGM is not practical for most shareholders and the ability of shareholders to nominate directors by other means is very circumscribed under corporate law (as is discussed below). It is CCGG’s view that shareholders should be able to replicate as closely as possible their ability to nominate directors at the AGM through the proxy voting process in alignment with contemporary shareholding and voting practices.⁷ The idea that shareholders should have influence on who makes up the slate they will be voting on also is consistent with the access accorded to shareholders under corporate statutes in other areas such as the ability to requisition a shareholder meeting or submit a shareholder proposal.

Today a shareholder’s efforts to influence the choice of directors generally is viewed by boards and management as a hostile attempt to wrest control from the existing board and management or to interfere with an area that is under the board’s purview. It is CCGG’s view that the board and management should instead welcome the input of shareholders in this important area as bringing the perspective of owners and stewards.

⁶ CBCA section 137(4), H.R. Nathan, *Nathan’s Company Meetings Including Rules of Order*, 8th ed. (Scarborough: Carswell, 1998 at 82). Advance notice bylaws place conditions on this ability. Although CCGG is not arguing that companies should have this ability removed entirely, CCGG believes that companies should not use advance notice bylaws or any other mechanisms to impede the proxy access policy described in this paper.

⁷ This reasoning was one impetus behind the SEC’s adoption of its proxy access rule (see [Facilitating Shareholder Director Nominations](#), SEC Release NO. 33-9046 (June 10, 2009) at page 9) and was recently reiterated by SEC Commissioner Luis A. Aguilar in a February 19, 2015 [public statement](#).

The overarching idea behind enhanced proxy access is the view that shareholders' ability to have a meaningful say in the nomination of directors is a benefit to the corporation and a fundamental tenet of shareholder democracy. It should not be interpreted as hostile to management and the board. A key underpinning of our corporate laws and our capital markets is the concept that shareholders elect directors, but CCGG believes this principle of shareholder democracy needs to have substance if it is to be meaningful. A slate of nominee directors in non-contested director elections, where the number of nominees is equal to the number of director openings and all such nominees have been selected by the existing board, often with the input of the CEO, and which is established without any meaningful input into its composition by the voting participants, is not true shareholder democracy. As stated by the SEC in its Proposed Rule on *Facilitating Shareholder Director Nomination*, "the right to nominate is inextricably linked to, and essential to the vitality of, a right to vote for a nominee".⁸

There also is some evidence that proxy access is appropriate not only on principle but also because it may enhance value. The CFA Institute Report noted above concluded following an investigation of the available global data that the results of existing event studies that looked at market returns following

⁸ Proposed Rule on Facilitating Shareholder Director Nominations, Release Nos. 33-9046; 34-60089, June 10, 2009. See also Durkin v. Nat'l Bank of Olyphant, 772 F.2d 55, 59 (3d Cir. 1985) (where the court stated that "the unadorned right to cast a ballot in a contest for office, a vehicle for participatory decision-making and the exercise of choice, is meaningless without the right to participate in selecting the contestants. As the nominating process circumscribes the range of the choice to be made, it is a fundamental and outcome-determinative step in the election of officeholders. To allow for voting while maintaining a closed candidate selection process thus renders the former an empty exercise. This is as true in the corporate suffrage context as it is in civic elections, where federal law recognizes that access to the candidate selection process is a component of constitutionally-mandated voting rights." (Emphasis added))

proxy access events suggest that proxy access has the potential to “raise overall US market capitalization by between \$3.5 billion and \$140.3 billion”.⁹

During CCGG’s private engagement meetings with independent directors of Canadian public companies, we discuss whether and how shareholders have any input into nominating directors. We believe that now is the time to bring our views on proxy access forward in order to begin a public dialogue in Canada about enhancing proxy access. While the dialogue is in its early stages and thinking in this area will undoubtedly evolve, this document presents CCGG’s current policy on proxy access for Canada.

Background

Canadian law currently provides shareholders with some means of proxy access by recognizing and establishing a statutory right of shareholders to nominate directors. For example, a shareholder holding five percent of a CBCA company’s outstanding shares may (i) requisition a meeting to elect directors¹⁰ or (ii) submit a shareholder proposal to nominate directors to be included in the company’s proxy circular.¹¹ In the latter case there is no statutory requirement for the corporation to include information about the shareholder’s nominee in the circular in an equitable manner in the same location as the company’s nominees with the same prominence; there is no requirement to use a fair universal proxy form; and the shareholder proponent is restricted to a 500-word statement in support of the proposal, whereas the length of management’s response is unrestricted. In both cases, the shareholder can issue a

⁹Supra note 3, [Proxy Access in the United States: Revisiting the Proposed SEC Rule](#), page 8. Events included, for example, companies that elected shareholder-nominated directors or passed proxy access proposals.

¹⁰ CBCA section 143(1)

¹¹ CBCA section 137(4)

general public statement explaining its position but can only directly solicit up to 15 other shareholders without preparing a dissident proxy circular. Under Canadian corporate statutes and applicable securities laws, then, current proxy access mechanisms in practice are not effective at giving shareholder nominees the prominence in the circular that is likely to provide an effective platform, while the proxy solicitation rules can make it onerous and prohibitively expensive for shareholders to actively communicate with or solicit other shareholders to vote for those nominees.¹² Accordingly, nomination of director candidates by shareholders occurs only rarely in Canada. Further, in our experience, directors very seldom seek input from shareholders when selecting board nominees.

CCGG believes that enhanced proxy access along the lines CCGG proposes in this paper will increase shareholder involvement in the director nomination process. In addition to encouraging boards to engage with shareholders on board composition, CCGG espouses in this paper a specific proxy access mechanism whereby shareholders can nominate some directors directly onto the company's proxy. CCGG believes that this mechanism will be used sparingly by shareholders (as the discussion of global practice below suggests), most likely when company performance is poor and attempts to engage have failed. The likelihood of being used only rarely does not constitute an argument against the importance of this mechanism, however: the ability of shareholders under majority voting to remove directors in situations where a director does not receive a majority of votes cast in favour also is used very sparingly by shareholders but this fact says nothing about the fundamental importance of majority voting as a basic tenet of shareholder democracy.

¹² For an expanded outline of the mechanisms currently available to shareholders to nominate directors under the CBCA, for example, see CCGG's 2010 [Brief](#) to the Standing Committee on Industry, Science and Technology and the CBCA comment letter cited above in note 1. For a discussion of the challenges presented by these alternative methods and others available see our 2010 Brief pages 8-9.

Most Canadians are not aware that there already are countries which offer variations on the right of proxy access as a matter of course.¹³ For example:

- In Sweden, nominating committees are comprised of representatives of four or five of the largest shareholders together with the chair of the board, and the nominating committee recommends director nominees to shareholders to be voted on at the AGM. The nominating committee also recommends to the AGM a process and criteria for selecting the members of the following year's nominating committee.¹⁴
- In Australia, the rules for nominating director candidates generally are governed by the individual company's constitution and we understand that in most listed companies one shareholder owning one share is able to nominate a board candidate.¹⁵
- In Germany, a shareholder holding any number of shares can nominate a director and provide a supporting statement not longer than 5000 words.¹⁶
- In Italy, under the 'voto di lista' mechanism, at least one nominee on every slate presented to shareholders at the AGM is proposed by minority shareholders holding a minimum percentage

¹³ In the United Kingdom director nomination rules are similar to Canada's with shareholders needing to hold five percent of shares outstanding in order to nominate a director by shareholder resolution or, alternatively, 100 shareholders holding shares worth at least 100 GBP each can nominate directors. However, no holding period is required and shareholders can provide a statement of up to 1000 words in support of a resolution.

¹⁴ For a review and analysis of the Swedish model see Tomorrow's Company's March 2010 study *Tomorrow's Corporate Governance: Bridging the UK engagement gap through Swedish-style nomination committees*.

¹⁵ Discussions with the Australian Council of Superannuation Investors

¹⁶ [Nomination of Directors under U.S. and German Law, David C. Donald, Institute for Law and Finance Johann Wolfgang Goethe-Universitat Frankfurt](#)

of shares based on market capitalization, and information about such shareholder nominee(s) is included in proxy materials alongside information about company nominees.¹⁷

- In Brazil, minority shareholders of a controlled company that hold any number of shares can propose one or two directors (depending on the company's corporate structure) to the controlling shareholder's slate.¹⁸

The International Corporate Governance Network also has weighed in on the topic of proxy access. Its 2014 Global Governance Principles include the following statement: "The board should ensure that shareholders are able to nominate candidates for board appointment. Such candidacies should be proposed to the appropriate board committee and, subject to an appropriate nomination threshold, be nominated directly on the company's proxy."¹⁹

While CCGG recognizes that relevant differences exist in capital markets around the world that will impact the appropriate form of corporate governance, including the form of proxy access, what should be noted from this brief global overview is that shareholders' ability to influence the nomination process or to directly nominate some directors is, first of all, viewed as an important right and, second, is one that should not be overly onerous to exercise.

¹⁷ [Appointment of Directors in Italy "Voto di lista" Proxy Access in Italy: it works! How the institutional investors protect their interests in Italian public companies, Trevisan & Associati Studio Legale](http://www.trevisanlaw.it/wp-content/uploads/misc/attachments/Appointment%20of%20directors%20in%20Italy%20-%20Voto%20di%20lista.pdf)
<http://www.trevisanlaw.it/wp-content/uploads/misc/attachments/Appointment%20of%20directors%20in%20Italy%20-%20Voto%20di%20lista.pdf>

¹⁸ [Proxy Solicitation and Shareholder Director Nominations in Brazil, Bruno Robert, February 20, 2011](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1765357&download=yes)
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1765357&download=yes

¹⁹ Global Governance Principles, section 3.5, International Corporate Governance Network, 2014

The history of proxy access in the U.S. has been mixed but seems to be reaching a critical point in 2015 with the tide appearing to turn in favour of proxy access. Notably, in February 2015, General Electric Company, one of the largest and oldest U.S. public companies, adopted a bylaw that allows shareholders access to the proxy if they hold three percent of the outstanding voting shares for a three-year period.²⁰ This was followed by Citigroup, Prudential Financial and Bank of America, among others, adopting or proposing to adopt similar proxy access bylaws. Over 30 companies have adopted, or agreed to adopt, proxy access in the U.S. to date²¹, either voluntarily or in response to shareholder proposals that garnered majority shareholder support, even though there is no legal requirement to do so.

A large part of the momentum can be attributed to a group of institutional shareholders in the U.S., led by New York City comptroller Scott M. Stringer, which in November 2014 announced the “[Boardroom Accountability Project](#)” initiative with the goal of convincing 75 U.S. companies to adopt bylaws allowing shareholders who have owned at least three percent of a company’s voting shares for three years or more to nominate up to 25 percent of the board of directors. The comptroller, who oversees five municipal public pension funds with \$160 billion in assets, has been joined by CalPERS, the largest U.S. public pension fund, and pension funds from Connecticut, Illinois and North Carolina, and they are encouraging other institutional shareholders to support the move. According to the comptroller: “The bottom line is, friends still put friends on boards...My job as a long-term investor is to make sure that these companies truly represent the interest of share owners.”²²

²⁰ [GE to Allow Proxy Access for Big Investors](#), Ted Mann and Joann S. Lubin, Wall Street Journal, February 11, 2015

²¹ Council of Institutional Investors [List of companies that have adopted proxy access](#) (with details of access mechanisms)

²² *Effort Begins for More Say on Directors*, Gretchen Morgenson, The New York Times, November 6, 2014 http://www.nytimes.com/2014/11/06/business/effort-begins-for-more-say-on-directors.html?_r=0

TIAA-CREF, another one of the largest U.S. pension funds, also sent letters to 100 of its largest holdings this proxy season urging them to adopt proxy access.

The up and down history of proxy access in the U.S. is instructive. In its [2010 Final Rule: Facilitating Shareholder Director Nominations](#), the U.S. Securities and Exchange Commission (“SEC”) recommended that shareholders holding three percent of the outstanding voting shares for a three-year period should be able to nominate up to 25% of the directors in the company’s proxy materials, provided such shareholders certify that they are not holding the stock for purposes of changing control of the company or to gain more than minority representation on the board. The rule was challenged in a lawsuit by the United States Chamber of Commerce and the Business Roundtable and struck down by the U.S. Court of Appeals on the basis that the SEC did not do a sufficient cost/benefit analysis of the rule.²³ Following this decision, the then SEC Chair reiterated the importance of shareholders having a meaningful way to nominate directors:

“I firmly believe that providing a meaningful opportunity for shareholders to exercise their right to nominate directors at their companies is in the best interests of investors and our markets. It is a process that helps make boards more accountable for the risks undertaken by the companies they manage. I remain committed to finding a way to make it easier for shareholders to nominate candidates to corporate boards.”²⁴

The above noted August 2014 CFA Institute Report encourages the SEC to re-examine the issue of proxy access and provides through its event study analysis a limited cost/benefit analysis to support its adoption.

²³ Interestingly, some recent research suggests that it is not feasible to do precise, reliable, quantified cost/benefit analyses on what are essentially public policy regulations. For example, see *Cost-Benefit Analysis of Financial Regulation: Case Studies and Implications*, John C. Coates IV, Harvard Law School (May 7, 2014) Yale Law Journal, Forthcoming; Harvard Public Law Working Paper 14-33

²⁴ Statement by SEC Chairman Mary L. Schapiro on Proxy Access Litigation: <http://www.sec.gov/news/press/2011/2011-179.htm>, September 6, 2011

Notwithstanding the Court of Appeal's decision, proxy access continued to make headway in the U.S., albeit with some setbacks.²⁵ In 2014, approximately 20 proxy access shareholder proposals were filed, with an average level of support of approximately 40 percent. Six shareholder proposals for proxy access received a majority of the votes cast²⁶ while three other proxy access shareholder proposals came very close to passing.²⁷ In addition, management at Verizon Communications Inc. and CenturyLink Inc. introduced proxy access proposals, both winning a majority of shareholders' votes in support.

In December 2014, in a setback for proxy access advocates, the SEC ruled that Whole Foods Market Inc. could exclude a proxy access shareholder proposal on the basis that it directly conflicted with Whole Foods' own proxy access proposal which set a much higher threshold of owning nine percent of the company's shares for five years rather than the three percent/three year threshold put forward by the shareholder proponent. Following the SEC decision, approximately two dozen other companies asked the SEC if they could exclude proxy access shareholder proposals on the same basis. After governance advocates, including the Council of Institutional Investors, complained to the SEC, on January 16, 2015 the SEC essentially reversed its earlier decision on Whole Foods and later released the statement that "In light of [SEC] Chair White's direction to the staff to review Rule 14a-8(i)9 and report to the Commission on its review, the Division of Corporation Finance will express no views" in the current proxy season on challenges to shareholder proposals that cite similar pending management proposals.

²⁵ *Proxy access support reaches new level*, Barry B. Burr, Pensions & Investments, July 7, 2014

²⁶ Namely, Abercrombie & Fitch, Big Lots, Boston Properties, International Game Technology, Nabors (for the third time²⁶) and SLM Corp.,

²⁷ at Walgreen, Comstock Resources and Kilroy Realty

The SEC now is reviewing the rules about excluding conflicting proposals but, given the increasing number of companies adopting proxy access this year, the outcome of the SEC's review may be moot.

CCGG's Enhanced Engagement and Proxy Access Policy

CCGG's view is that independent directors should communicate with shareholders on a regular basis to seek their input on board composition, including appropriate director candidates. Absent a formal structure for shareholder input into the nomination process such as exists in Sweden, the form of this communication should be within the discretion of the particular company, provided that it leads to real dialogue between shareholders and directors about board composition. For example, directors can contact the company's largest shareholders on the matter at least annually as part of regular board/shareholder dialogue or can provide an effective and practical means for shareholders to initiate communications with directors. Regular discussions with shareholders should include requests for input on board composition, including appropriate director candidates.

In addition to shareholders being able to influence board composition through on-going dialogue, CCGG believes that proxy access should be available to shareholders on the following basis so that shareholders have the ability to directly nominate some directors when warranted.

Meaningful Ownership Level – Three or Five Percent Depending on Market Capitalization

CCGG believes that shareholders holding a meaningful percentage of a company's outstanding voting shares should have the opportunity to present director nominee(s) to shareholders in the company's

proxy materials. CCGG believes that an appropriate threshold that would enable shareholders to influence the nomination process without risk of overwhelming that process is five percent for a company with a market capitalization of less than \$1 billion and three percent for a company with a market capitalization of \$1 billion or more.²⁸ Shareholders should be permitted to coordinate and aggregate their holdings to reach the required threshold. Any higher threshold would render this form of proxy access impracticable and defeat the objective of providing shareholders with a reasonable mechanism for nominating directors directly.²⁹

Shareholders must continue to hold the relevant percentage of shares up to the time of the meeting at which the director nominees will be considered.

This form of proxy access is another area impacted by the problems associated with empty voting. CCGG's view is that proxy access should not be available to shareholders whose economic ownership interest does not reflect their voting interest (for example, because of short selling or the use of derivatives) with respect to the level of outstanding shares that provides the basis for their access to the proxy. Accordingly, proxy access should be available only to shareholders that represent that their economic ownership interest, being the amount of their equity in the company "at risk", is equal to their voting interest with respect to at least three or five percent of the outstanding voting shares depending

²⁸ The five percent and three percent thresholds were decided upon, in part, after reviewing the number of companies listed on the TSX and the TSX-V with market capitalizations either above or below \$1 billion: 82.2% of the 1,521 companies listed on the TSX have a market capitalization of less than \$1 billion and 99.9% of the 1,953 companies listed on the TSX-V have a market capitalization of less than \$1 billion. 92.2% of the 3,474 companies on the two exchanges combined have a market capitalization of less than \$1 billion.

²⁹ This reality explains the vociferous opposition by shareholders and their representatives in the U.S. to the nine percent threshold put forward by Whole Foods.

on market capitalization and that such percentage will be held until the meeting at which the shareholder nominees are proposed for election.³⁰

Cap on number of nominees

In order to distinguish this normal course access to the proxy from situations where a change of control of the board is the goal, the number of shareholder nominees permitted under a proxy access mechanism should be capped.³¹

To avoid ‘creeping board control’ through the proxy access mechanism, shareholders should be restricted to nominating the lesser of three directors or 20 percent of the board. Shareholders would not be able to nominate another three directors or 20 percent of the board in following years so long as the previously nominated directors, if elected, remain on the board.

Where more than one shareholder or group of shareholders holding three or five per cent of an issuer’s shares depending on market capitalization wish to nominate directors by proxy access, each eligible shareholder will select one nominee until the maximum number is reached, going in order from the largest to the smallest shareholder. If the maximum number is not reached in this manner, the selection

³⁰As an analogy, clause (b) of the definition of “synthetic disposition arrangement” in Section 248(1) of the Income Tax Act provides an example of a legislative test where a person is deemed not to own shares or to have disposed of shares. The relevant language is as follows: “synthetic disposition arrangements’... means one or more agreements or other arrangements that ...have the effect... of eliminating all or substantially all the taxpayers risk of loss and opportunity for gain or profit in respect of the property for a definite or indefinite period of time.”

³¹Note that there currently is no cap on the number of directors who can be nominated under the relevant shareholder proposal provisions in section 137(4) of the CBCA.

process will continue as many times as necessary, following the same order each time until the maximum number is reached.³²

In addition, in order to provide comfort that a shareholder is not seeking control, a representation to that effect should be required from shareholders nominating directors by proxy access.

Fair disclosure in the proxy circular and form of proxy

CCGG believes that the disclosure about shareholders' director nominees in the company's proxy circular and form of proxy should be set out fairly and on an equal footing with company nominees. Equal footing requires that shareholder nominees be placed in the same location as company nominees in the proxy circular, that the same opportunity to present information on nominee background and qualifications is available for all nominees and that a fair form of universal proxy is used³³. CCGG believes that all relevant information about any compensation being paid to shareholder-nominees should be clearly disclosed in the proxy circular as well in order to let shareholders know of any 'golden leash' arrangements that may be relevant to shareholders when determining how to vote.

To the extent required, the law should be changed so that inclusion of the shareholder nominee information in this manner allows shareholders who have nominated directors to communicate with other shareholders and solicit proxies with respect to their nominees without requiring the filing and

³² This mechanism is the one that General Electric, for example, has adopted in its proxy access policy.

³³ Provided that shareholder nominees are on the same form of proxy with the same prominence as company nominees, we do not object to shareholder nominees being listed separately from company nominees as long as they are presented on the same page.

distribution of a dissident proxy circular, on the basis that the company's proxy circular in effect functions as a proxy circular for the shareholders as well.

Reasonable solicitation costs on the part of the shareholder should be paid by the company, unless the majority of shareholders that vote at the meeting resolve otherwise, with the goal being to level the playing field between shareholder and company nominees with respect to solicitation costs.

No holding period required

CCGG does not believe that a holding period is necessary either to ensure that proxy access is restricted to shareholders with a long term perspective on the company (rather than shareholders looking to exploit short term gain) or to avoid vexatious nominations. Past behaviour is not necessarily indicative of future intention and it cannot be assumed that a shareholder that purchased shares only recently does not have a long term perspective. A recent study based on consultations with shareholders and other market participants on loyalty-driven securities (i.e., additional voting rights for shareholders that have held their shares for a specific period of time) indicated that "Importantly, participants were not comfortable with the notion of identifying 'long term shareholders' on the basis of holding periods".³⁴ Shareholders that are not seeking to change control of the board should be able to access the company's proxy and then let the shareholders decide at a shareholder meeting which directors they wish to elect.³⁵

³⁴ [Building a Long Term Shareholder Base: Assessing the Potential of Loyalty-Driven Securities Consultation Findings](#): 2013, Mercers and Stikeman Elliott LLP, commissioned by The Generation Foundation

³⁵ In the U.S., the shareholder proposals asking for proxy access that receive the highest percentage of votes in favour are those with a holding requirement of three years (along with a holding threshold of three per cent). The successful proposals mentioned in footnotes 26 and a large majority of the bylaws adopted by companies mentioned in the Council of Institutional Investors list in footnote 21 were all three percent/three year proposals.

Implementation

Amendment of Corporate Statutes

As stated in our May 2014 [submission](#) to Industry Canada on possible amendments to the CBCA, CCGG believes that the CBCA, as well as the provincial corporate statutes, should be amended to introduce a proxy access mechanism provision consistent with the features described above. The corporate statutes are an appropriate location for proxy access provisions given that they currently provide alternative mechanisms for nominating directors (namely, through the five percent shareholder proposal mechanism to nominate directors or by permitting shareholders holding five percent or more of the outstanding shares to requisition a meeting to nominate directors). The securities statutes also should be amended to the extent necessary to permit proxy solicitation by shareholders utilizing the company's proxy circular, as described above.

Voluntary Adoption

Until statutes are amended to provide shareholders with a reasonable form of proxy access, CCGG encourages companies to adopt this form of proxy access voluntarily, as General Electric, Citigroup, Prudential Financial and Bank of America among others have done in the U.S.³⁶, and also to increase dialogue between directors and shareholders about board composition. CCGG sees an important parallel between the adoption of majority voting as an accepted best practice in Canada, and now a TSX listing requirement, and the adoption of our suggested form of proxy access: both deal with the

As stated above, however, CCGG does not believe that a holding requirement achieves the purpose it is intended to serve.

³⁶ See footnote 21.

fundamental right of shareholders to have a say on who will represent them on the board.³⁷ CCGG would like to see this form of proxy access in Canada follow a trajectory similar to the adoption of majority voting albeit over a shorter time frame. We are confident that over time proxy access will be recognized as a benefit to shareholders and issuers alike as well as a fundamental right of shareholders. Accordingly, CCGG will continue to encourage this form of proxy access during our board engagements and to urge legislators to enshrine the practice in statute. We also will continue to encourage boards to communicate with shareholders on a regular basis about board composition.

Objections to Proxy Access

We do not anticipate objections to CCGG's view that directors should communicate regularly and in the ordinary course with shareholders about board composition. The arguments set out below, however, are ones that we have heard from time to time against the idea of the type of proxy access that permits shareholders to nominate some directors directly onto the proxy, to which we respond.

There already are mechanisms in place under Canadian corporate law to facilitate shareholders' ability to nominate directors

The alternative mechanisms in existence in Canada today – submitting a shareholder proposal or requisitioning a meeting to nominate a director once a shareholding threshold of five percent has been reached, as noted above – can be overly onerous and expensive if shareholder support is sought and also do not allow for a level playing field for disclosure between company and shareholder nominees.

³⁷ We note that 'say on pay' generally was viewed as a radical and unworkable idea in Canada as recently as five years ago before it was voluntarily adopted as a 'best practice' by approximately 150 of Canada's largest public issuers as at November 2014.

Support for CCGG's suggested form of enhanced proxy access is based on the view that shareholders' ability to nominate directors is a benefit to the corporation and should not be discouraged.

In that vein, CCGG believes that shareholders' nominees should be included on the same form of proxy as company nominees and the same disclosure, in the same place, should be provided for all nominees in the company's proxy circular. The rules for submitting a shareholder proposal vary across provinces but none of the statutes specifically require that a director who is nominated by shareholder proposal be included on the same list of directors on the form of proxy with company nominees; rather, typically the supporting statement for a shareholder's nominee is limited to a certain number of words and need not be found in the same part of the circular as information about director nominees.

Importantly, shareholders nominating a director in Canada cannot solicit more than 15 proxies without having to file a dissident proxy circular, which can be a prohibitively expensive proposition that makes the current proxy access mechanism impracticable for most shareholders.

Proxy access will enable short term investors to impact the company in ways not in the best long term interests of the company

CCGG is of the view that shareholders are able to decide which candidates will make the best directors when given sufficient information about those candidates in the proxy circular, an essential feature of proxy access as CCGG envisions it. Shareholders are free to accept or reject nominees as they see fit, whether they have been put forward by the company, by a long time shareholder or by a shareholder that has recently acquired its three or five percent holding depending on the company's market

capitalization. As noted above, CCGG believes that a shareholder's perspective cannot be ascertained simply by the length of time that shares are held.

As a means of reducing the 'short term' threat and restricting proxy access to shareholders interested in the long term well-being of the company, some argue that a holding period of, for example, three years should be required before a shareholder can have access to the proxy. While it may be argued that the period of time during which a shareholder has owned shares is indicative of intention, CCGG believes that a holding period requirement for proxy access in effect creates two classes of shareholders, which is a concept CCGG does not support.³⁸ Generally, shareholders are averse to efforts to establish differential rights among shareholders. The Report for the Generation Foundation referred to above found, after consultations with institutional investors and other market participants, that "with the exception of a small number of participants in the consultations (including existing issuers of loyalty-driven securities) issuers and investors consulted did not view loyalty-driven securities (and the commensurate differential rights for shareholders of a certain holding period) as an attractive proposition" in efforts to encourage a long term perspective on the part of shareholders.³⁹

Proxy access will allow shareholders with special interests not in line with the interests of other shareholders to be represented on the board

Concern is expressed that directors nominated by certain shareholders would be beholden to those shareholders and their interests rather than the interests of shareholders generally. However, any

³⁸ Note that holding periods are not required in other countries such as Australia, the United Kingdom or Italy that have low thresholds for proxy access

³⁹ Supra note 34, [Building a Long Term Shareholder Base: Assessing the Potential of Loyalty-Driven Securities Consultation Findings](#)

shareholder nominee must gain the support of a sufficient number of other shareholders that vote at the meeting in order to obtain a seat on the board, which should negate the concern that ‘special interests’ will prevail.⁴⁰ The CFA Institute Report referred to above found limited evidence to suggest that special interest groups can use proxy access to hijack the election process or pursue special interest agendas. In addition, under Canadian corporate law, a director has a fiduciary duty to the corporation and not to any specific shareholder group.

Issuers will be inundated with director nominees

The fear of being inundated with director nominees is unwarranted and not supported by evidence. In the many jurisdictions where proxy access is available, the reality is that issuers are not overwhelmed with director nominees, even when the threshold is as low as holding one share. Evidence suggests that where low thresholds for ownership and duration of ownership exist, proxy access has not disrupted the election process.⁴¹ In any event, the fear of inundation does not negate the benefit or appropriateness of shareholder input into the nominating process.

Shareholder nominees will hinder board performance

The argument often is made that external input into the choice of board nominees will interfere with board cohesiveness and thus the effectiveness of the board. Without question choosing directors that are a right ‘fit’ for the company and the board as a whole (including having the right skills, expertise, temperament, integrity and independence of mind to meet the boards’ skills matrix requirements) is important. In order to make an informed decision regarding proposed directors, sufficient and clear

⁴⁰ In addition, in this paper we indicate that “golden leash” payments must be clearly disclosed in the proxy circular.

⁴¹ The CFA Institute Report, page 9

disclosure is required in the proxy circular about every board nominee, as suggested in this paper, whether the nominee is proposed by the company or by shareholders. With that disclosure, however, shareholders will be able to make a meaningful and informed decision as to who will best serve the company.

Again, the evidence does not support the view that shareholder input into the nomination process hinders board performance or effectiveness⁴².

'If it ain't broke, don't fix it'/Proxy access is a solution looking for a problem

As noted above, CCGG believes that proxy access should be enhanced to address the fact that current proxy voting practices do not make it practicable for shareholders to exercise their right to nominate directors at the AGM, a right bestowed by Canadian statute. The practical inability to exercise a right can correctly be viewed as a broken system or a problem in need of a solution. CCGG also believes that the current director selection and evaluation process and the quality of board performance are in need of repair, as evidenced by the McKinsey statistics quoted above.⁴³ The enhanced proxy access mechanism proposed in this paper offers means of helping to address the need.

As noted above, CCGG also believes that this form of enhanced proxy access will be used sparingly by shareholders just as is the right to nominate a director from the meeting floor today. But just as the scarcity of failed director elections does not reflect on the need for majority voting, the fact that

⁴² Ibid, page 45

⁴³ See footnote 4.

enhanced proxy access is unlikely to result in many instances of its use does not lend support to the argument that enhanced proxy access is unnecessary.⁴⁴

Summary

CCGG recommends that companies adopt policies and procedures that will enable shareholders to communicate with independent directors about board composition on a regular basis. CCGG further recommends that Industry Canada amend the CBCA (and that the corporate statutes in the provinces and territories be similarly amended as well as securities statutes to the extent necessary) in order to include proxy access provisions consistent with the following terms. Issuers are encouraged to adopt such a proxy access policy voluntarily in advance of statutory change.

- Shareholders holding an aggregate economic and voting interest of at least five or three percent of an issuer's outstanding voting shares, depending on the company's market capitalization, should be able to nominate directors to be placed on the same form of proxy as the company's nominees.
- Shareholders must hold the prescribed percentage of shares up to the time of the meeting at which the shareholder- nominees are proposed for election.
- Disclosure about shareholder nominees should be set out fairly in the company's proxy circular, including being located in the same section of the proxy circular with the same prominence and

⁴⁴ Similarly, lack of empirical evidence as to whether shareholders have been frustrated in their desire to impact board composition is not determinative of whether they should have the ability to have that impact. Sometimes decisions should be based on what one believes is right, even in the absence of definitive empirical evidence. A similar point is made by Ira M. Millstein in quoting Nobel laureate economist Robert M. Solow: "In economics, model builders' busywork is to refine their ideas to ask questions to which the available data cannot give the answers...There is a tendency to undervalue keen observation and shrewd generalization...there is a lot to be said in favor of staring at the piece of reality you are studying and asking, just what is going on here?" I.M. Millstein, "Red Herring over Independent Boards" *The New York Times* (6 April 1997) Money & Business 10.

on essentially the same terms as disclosure about the company's nominees, along with the use of a fair 'universal proxy' form.

- Shareholders do not need to hold their shares for a specific period of time before they are permitted to nominate a director.
- The number of directors to be nominated by shareholders cannot exceed the lesser of three directors or 20 per cent of the board.
- Shareholders nominating directors should be able to use the company's proxy circular to solicit support.
- Reasonable solicitation costs on the part of the shareholder should be paid by the company unless shareholders resolve otherwise.
- Shareholders nominating directors must make representations that they are not seeking control and that their economic ownership interest is at least five or three percent, depending on the company's market capitalization, of the issuer's outstanding voting shares.

CCGG believes the adoption of a meaningful process for receiving shareholder input on a regular basis about board composition, including the director nomination process, along with the adoption of the method of enhanced proxy access outlined above, offers a practical mechanism that would make the shareholders' right to elect directors meaningful and will assist in holding boards accountable and in improving board composition and performance.