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+ SPECIAL REPORT
PREPARING FOR PROXY SEASON

One if by land, two if by proxy

Dissidents and activists aren't just coming, they're already here. That's why it's never too early to prepare for the next proxy season

By Celia Milne

It started with a rumour and very nearly ended with the loss of a company.

Like a growing number of proxy contests, it was to be a stealth attack. The response had to be fast and furious.

The founder (he's also president and CEO) of a small cap chemical production company—we'll call it Acme Chemicals—was tipped off that a large shareholder was about to attempt a takeover. The dissidents' plan, he heard, was to nominate a replacement slate of directors at the shareholder meeting, which was in only two weeks.

There was no outward sign of trouble. In stealth proxy battles, dissidents don't issue a dissident circular; instead, they typically target a small number of significant shareholders, solicit their votes privately, then strike at the AGM. Yet Acme's intelligence indicated that 80% of the votes were evenly split between the dissidents and management. It was time to mobilize the other 20%, held mostly by passive retail shareholders—and to do it quickly.

"If you think you may be in trouble, you probably are," says Brad Allen, senior vice-president of proxy solicitation firm Laurel Hill Advisory Group in Toronto, which was hired in this case to help fend off the activists.

The plan? Identify as many remaining large shareholders as possible. Let each of them know the importance of voting and supporting management. Use the complicated proxy voting guidelines to advantage. Work with the company's lawyers to determine rules around dissidents delivering proxies designed to derail the board. Review the chairman's script for the meeting to cover all possibilities of dissident action.

By proxy cut-off time, Acme Chemicals had gained enough votes to support its board. This issuer's counter-stealth attack surprised the dissidents, who appeared at the meeting but left with their tails between their legs. "This client would have likely lost his company if he did not immediately recognize he had a potential serious issue and took steps to seek expertise to assist," says Allen.

The story of Acme Chemicals and companies like it reflects a growing wave of vulnerability for issuers, particularly medium and small cap firms. They need to keep close tabs on the investor psyche, as well as their own compliance standards and strategic execution, or they could find themselves gun slinging in a proxy battle, either secret or overt.

Since the early 2000s, the number of public proxy contests in Canada has grown steadily, hitting a peak of 43 in 2009. That doesn't count all the challenges launched, and thwarted, behind the scenes. While the overall number of fights and activist proposals was down in 2010—due in large part to investor satisfaction with the big recovery in the markets in late 2009—shareholders continue to grow increasingly sophisticated and demanding of openness and good value. Allen's advice to issuers: Communicate well at all times and gauge key shareholder sentiment. "Don't put yourself in a position to need to ask for shareholder support as the first conversation with a key shareholder," he says.

Listed sat down with experts like Allen to talk about the essentials of proxy season preparation—whether it's the pre-AGM proxy documents themselves or related issues. We gathered perspectives from key sources among investor relations, corporate secretaries, shareholders and proxy solicitation companies. What emerged were several key points for a fall to-do list: Find out who your investors are, stay in touch with them, communicate clearly and plainly, address shareholders' issues while sticking to the company's vision and strategic plan, involve investors in pay decisions, and know today's hot button issues and what's going on in your industry.

Fall planning

Any company with a calendar year fiscal must hold its AGM before the following June 30. That's why the planning should start now. "Fall is usually when you start to get ready for proxy season. Whether you hire a proxy solicitation company or not, it's time for the very beginning stages," says Penny Rice, vice-president of advisor services at Laurel Hill.

Early preparation involves proxy solicitation, pre-meeting analysis of resolutions, consistent reporting to shareholders, making note of troubling feedback from investors, and ensuring there's continued involvement around these issues by senior management. It's also critical, according to Roy Shanks, chief operating officer at proxy solicitor Georgeson, to monitor statements from RiskMetrics and other proxy governance advisors. Institutional investors rely heavily on these firms' recommendations for guidance on proxy proposals.

David Masse, vice-chairman of the Canadian Society of Corporate Secretaries, says the first step in the planning cycle is to lay out critical dates, such as the record date that determines who is entitled to attend and vote at the meeting, or the date on which regulatory filings will be carried out. Masse, who is also senior legal counsel and assistant corporate secretary for information technology giant CGI Group Inc., describes the synergy between departments there. The IR department handles logistics for the AGM, including the date and venue. The investor relations staff members work with the corporate secretary. "We collaborate closely on the annual meeting script. IR prepares and dovetails the business and shareholder presentations into the legal portion of the script that we provide."

The fall is a good time, if you haven't done so already, to get to know your shareholders. It's one of the basic fundamentals of preparing for proxy season. "The key to dealing with any issues at the AGM is knowing who your investors are and communicating with them regularly. Then you won't get surprised," says Wes Hall, president and CEO of Kingsdale Shareholder Services in Toronto. It's at this stage where many companies will hire a proxy solicitation firm to help. "Preparedness is a key," says Glenn Keeling, a veteran proxy advisor and now a partner in the firm Phoenix Advisory Partners of Toronto. "Some firms use a proxy solicitor as a strategic partner all year long. It's almost automatic in the U.S. Here, it's still just a handful."

Among the three types of investors—moms and pops, who have a stock certificate in their own name; NOBOs, who hold stock through a brokerage and have no objection to the company knowing who they are; and OBOs, who hold stock and object to their identity being exposed—the OBOs are the elusive ones. Important OBO votes can get lost in the system, says Hall.

Proxy solicitation companies such as Kingsdale, Laurel Hill, Georgeson

The best defence

Want to defuse a proxy fight? Start talking

It was a proxy battle fought and won.

TransAlta, the largest investor-owned energy producer in Canada, came under fire from dissident shareholder Luminus Management—a New York hedge fund and its largest investor—in early 2008. Luminus wanted TransAlta to load up on debt in order to finance additional growth and increase its stock price. In 2008, the conflict escalated to the point where Luminus launched a $7.8-billion takeover bid.

"When you have activist shareholders, they can take advantage of proxy season," says Jennifer Pierce, vice-president of communications and investor relations at TransAlta. The company formed a special committee to address Luminus' concerns. "We were able to reach an understanding that TransAlta was executing on strategy. The corporation must be delivering the greatest value for all shareholders," says Pierce. Luminus withdrew.

Of the 43 proxy battles that were launched in Canada in 2009, approximately one-third were withdrawn, one-third were won by dissidents and one-third were won by management. "What makes companies vulnerable to proxy battles? Sometimes nothing," says Pierce. "Just a particular shareholder with a certain vision."

TransAlta acted by the book, says Roy Shanks, chief operating officer at Georgeson. When targeted, Shanks says, a company should quickly establish an advisory team, then a special committee to deal with substantive issues, and also a communications committee to develop a protocol for the creation and dissemination of information to shareholders.

"Frequent shareholder communication is required," says Shanks. "Initially assess the threat and measure your response. Carefully construct the message. Ultimately, the shareholders decide the outcome. Finally, if there is an opportunity to engage with the dissident shareholders for the betterment of the corporation, one needs to consider if that discussion needs to be had." *—C.M.*

and Phoenix can help track down those mysterious OBOs, which are generally institutions. "It is not an exact science," says Hall. "The only way to find out who they are is if they voluntarily send out a press release or do early warning filings or you contact them. It's a moving target—who bought and who sold."

Communicate all year long

The best IR departments communicate with shareholders all year round, says Jennifer Pierce, vice-president of communications and investor relations at TransAlta, a large energy company in Calgary. "Our AGM is in April. There is no heating up of activities in the fall. We have ongoing dialogue long-term with shareholders, not just when proxy season comes around."

Yet even a large firm like TransAlta finds it challenging to know who its investors are. "It's triangulation trying to get a good shareholder list," says Pierce. "It's unfortunate but there is not that level of transparency among the shareholder community. Companies would be able to communicate more effectively if they knew who their investors were. The only way to have a specific relationship is to call them up and say, 'Is this your holding?'" she adds.

Better communication is a must, now more than ever. "What we're seeing emerge in the shareholder community is a desire to have direct communication with the board of directors. This is new in North America," says Pierce.

Rice from Laurel Hill advises small and medium-sized companies to learn from the big guys: Have a strong IRO team so that when a shareholder calls to ask a question, the question is noted in a database. "Shareholders will change, but at least that gives you a jumping off point," she says. "If they are angry and calling with an issue, then that issue may mushroom. If it is a consistent concern, take note. How might it impact the future? How large is the shareholder? If they own 10% or 15% and they are upset, ignoring them might give them fuel to start a proxy fight."

Indeed, according to a study of recent proxy activity by the law firm Goodmans, any time dissidents reach the point of issuing a proxy circular, there is a better than 50% chance they'll wind up altering the status quo. The greater number of shares they own directly, the more likely they are to succeed.

"You can't run a company by consensus but at the same time, a group of shareholders can get together," says Rice. "It's better to be ahead of them than chasing them." Communication methods include road shows to major cities, face-to-face meetings, a great website with an IR button, live forums and social media. New ideas include hiring a Twitter expert to get your message out, developing a CEO blog, and producing videos of your AGM.

Good governance

In recent years, the hot items each proxy season have been more or less the same—governance, executive compensation and environmental and social responsibility. It's a good bet those will be key again in 2011.

The rising influence of large institutional investors such as the Canada Pension Plan is a fairly recent phenomenon, says Stephen Griggs, executive director of the Canadian Coalition for Good Governance (CCGG) in Toronto. These shareholders recognize that good governance is integral to a successfully managed company. "Good governance practices will provide greater rate of return and lower the risk profile," says Griggs. "These are really basic things. If enough shareholders get upset or angry, they'll change the board."

Proxies should be helpful documents, says Griggs. "A lot should be disclosed or should be in the circular. We look for that commitment to democracy."

In this sense, good governance is also a hedge against the likelihood of a proxy fight. According to the Goodmans study above, companies face a higher probability of proxy fight if they're listed on the TSX Venture exchange. One reason, the report speculated, was that because governance rules for Venture firms are less restrictive than those on the TSX, companies that meet only minimum standards are giving dissidents more motivation and ammunition. Its advice: "Venture exchange issuers may consider mitigating the risk of facing a proxy contest by implementing more stringent governance policies."

Shareholders, says Griggs, are looking for vital information about issuers: the company's strategy and vision, as well as how risk is going to be managed. Directors should be truly independent, willing to stand for election, and have time to devote to the job. There should be a diversity of backgrounds relevant to the company. CCGG also looks for a separation between chair and CEO roles, as well as a description of experience and reason for each director. "The proxy should give shareholders the sense they are doing all these things," he says.

And it has to be readable. "We're pretty sophisticated. If someone like myself can't understand what the board is doing from their disclosure, that's a problem," says Griggs. Banks have hired plain language writers, and this initiative will filter down to smaller companies. "They should be aware this is coming. There is no reason someone can't sit down and write a proxy that a normal human being can understand."

Executive compensation

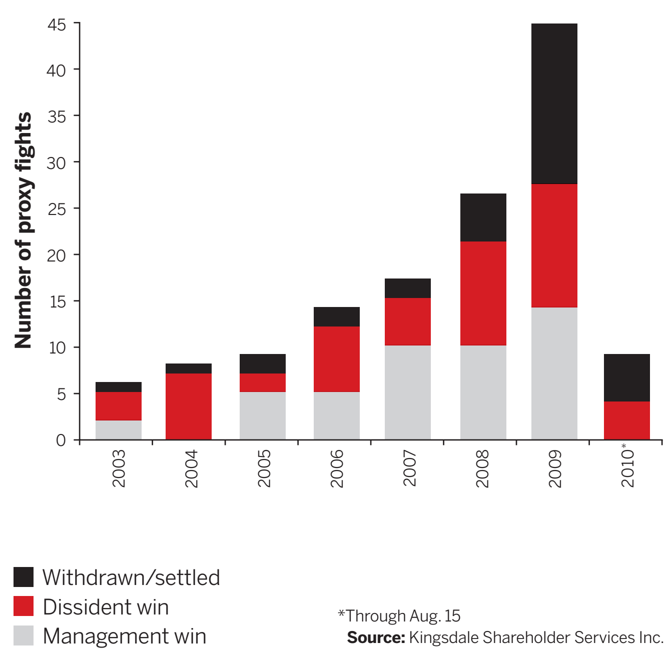
What are you paying your execs and why? This topic is hotter than hot. "Executive compensation comes up every year and seems to pick up momentum," says Rice. "For some institutions, this is a big issue and they'll hold your feet to the fire, depending on who holds the company." If executives are getting a huge payout, it is important to explain why that needed to be made. A lot of issuers' compensation programs are a year behind. So

2010 proxy contests*

Management	Dissident	Dissident Ownership	Dissident Objective	Outcome
Cell-Loc Location Technologies Inc.	Dr. Michel Fattouche	28%	Replace Board	Dissident
Crew Gold Corp./Endeavor Financial	Bluecone Ltd./Severstal	N/A	Replace Board	Settled
Gold Hawk Resources	Blue Note Mining Inc.	2.80%	Replace Board & Acquire Company	Withdrawn
HSE Integrated Ltd.	Forum National Investments Ltd.	8.50%	Replace Board	Withdrawn
Khan Resources Inc.	Laramide Resources Ltd.	13.20%	Replace Board	Dissident
Nordex Explosives	Concerned Shareholders	29%	Replace Board	Dissident
Staccato Gold Resources Corp.	Augen Capital Corp.	7.40%	Replace Board	Withdrawn
Unique Broadband Systems	Underlying clients of TD Waterhouse	5.60%	Replace Board	Dissident
Verena Minerals Corp.	Robert F. Rose	N/A	Replace Board	Settled

*Through Aug. 15
Source: Kingsdale Shareholder Services Inc.

Proxy contests in Canada



*Through Aug. 15
Source: Kingsdale Shareholder Services Inc.

if your executives are getting high compensation during a downturn, there's a disconnect that needs to be explained.

Explanations should be clear in the disclosure, says Griggs. "How are they using executive compensation to incent? You'd be amazed how often you can't find that." Adds Rice, "If you leave something out, people assume the worst, not the best."

The arrival of say-on-pay advisory votes at more than two dozen large companies in 2010 is a reflection of this sentiment. While non-binding, say-on-pay votes do give shareholders a formal chance to voice their approval or disapproval of executive pay packages; a strong negative vote should alert management to a problem and lead to further dialogue with shareholders. In 2011, close to 40 companies are expected to hold say-on-pay votes. Griggs calls this a "very positive" step.

Environmental disaster

Besides the ongoing environmental lightning rods that issuers have to monitor such as carbon footprint, climate change and greenhouse gas emissions, the new kid in town is the threat of environmental disaster. The recent oil spill in the Gulf of Mexico has investors feeling nervous this year, says Kingsdale's Hall. "A lot of shareholders are going to be concerned that billions of dollars could be lost in the market because of an environmental disaster such as the Gulf. They will look at other companies and ask, 'Could they have a similar disaster?' Issuers will be asked to quantify risk, believes Hall, adding that British Petroleum wouldn't have been able to do that last year.

New proxy rules

New rules are coming that may affect how companies handle proxy season. The time may be nigh for almost-paperless proxies. There's a proposal by the Canadian Securities Administrators to amend National Instrument (NI) 54-101, which prescribes how issuers communicate with their beneficial shareholders. Among the changes are "notice and access" rules which permit issuers to make their annual proxy materials available on a website rather than mailing hard copies.

While there is money to be saved on printing and postage, this benefit has to be weighed against the cost of website development and the risk that investors won't participate, says Rice. "Issuers are going to have to think in advance. Do you want to go that way? If you are highly retail, you might not want to be first to try it," she says.

Such changes can't come fast enough for members of the Canadian Society of Corporate Secretaries, according to Masse. NI 54-101 amendments represent an attempt to streamline the process for appointing beneficial shareholders as proxy holders. "Unfortunately," he says, "it is unlikely that the new rules will be in place for the 2011 season."

This is too bad, he says, because these changes would reduce the disparities between registered and beneficial shareholders. The current mechanisms make it tough for beneficial shareholders to exercise their voting rights in Canada.

The Canadian Society of Corporate Secretaries is pushing for changes that will level the playing field for all shareholders.

Your shareholders own your company. As you prepare for the 2011 AGM, expert advice says keep your finger on the pulse of what they are thinking and doing. Your future may depend on it.

***Celia Milne** is a freelance writer in Toronto.*