Proxy disputes alive and well in Canada

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Shareholder democracy activists should not get carried away by the arrival of proxy access proposals north of the border, according to a Toronto lawyer.

At their annual general meetings this spring, two of Canada's banking giants — Toronto-Dominion Bank and the Royal Bank of Canada — were the recipients of the first Canadian shareholder proposals for the adoption of proxy access bylaws, which would allow shareholder-nominated candidates to appear in the company's proxy circular alongside the management slate for election to the board of directors.

In narrow votes, RBC shareholders rejected the measures, while TD's came down in favour of the new bylaw.

Proxy access bylaws have taken off in the U.S. over the last decade to the point where more than half of the S&P 500 companies have them on their books.

However, Derek Bell, partner in the Toronto office of DLA Piper (Canada LLP), has his doubts about how effective such bylaws are for shareholders that want to exert more influence over the running of a company.

"Even in the U.S., where these proposals have been all the rage and adopted in many cases, they don't tend to be very robust, and, generally, attempts to make them stronger have not been successful," he says.

Although the TD and RBC bylaws were proposed by a single shareholder, anyone wishing to take advantage of them would need the support of at least five per cent of shareholders to get their nominees listed for election.

In the case of the Canadian banks, their huge market capitalization values mean the five-per-cent threshold could only be met by a group of shareholders with a holding worth around $4 billion.

"If you've got that kind of interest in a company, and you want to make a meaningful change to the board, you're not going to limp in with some proposal buried in a management information circular," Bell says.

"Proxy disputes are alive and well in Canada. I'm just not sure proxy access will ever by the chosen path for anyone to get on the board," he adds.

Patricia Olasker, whose practice at Davies Ward Phillips & Vineberg LLP involves advising parties on both sides of shareholder activism issues, says proxy access proposals could be a relatively cheap option for shareholders in smaller companies where broad public solicitation is not needed to win the backing of a dissident slate of director nominees.

"For activist or engaged professional investors, there are other, more effective ways to change the board," says Olasker, a partner in the firm's Toronto office.

At the Canadian Coalition for Good Governance, a group formed in 2003 to represent the interests of institutional investors, executive director Stephen Erlichman says it's too early to tell what long-term effect the TD and RBC votes will have.

"Those proposals came from a single shareholder, so it will be interesting to see if institutional investors bring their own next proxy season or if there's a domino effect with other financial institutions," he says.

Since 2015, the CCGG has called for public companies to enhance proxy access as a way to boost shareholder involvement in the selection process for director nominees.

Although shareholders get a chance to voice their displeasure with management choices during board elections, Erlichman says it doesn't mean much if there's no realistic way for them to put forward their own suggestions.

The Canada Business Corporations Act does provide a statutory mechanism for shareholders to nominate directors, but Erlichman says it's barely used because it is so "weak and ineffective."

The law only provides for a 500-word statement in support of the proposal in the company's proxy circular, but it says nothing about equitable treatment with management's slate of nominees.

"The company can bury the statement at the back of the circular, and can respond with their own 1,000- or 10,000-word statement in favour of their own nominees.

No corporate laws say how to carry out proxy access in a fair manner," Erlichman says.

Management tends to react defensively to what it views as hostile attempts by shareholders to influence the composition of boards, but Erlichman says it should welcome their input.

"We issued our proxy access paper to start a dialogue about shareholder involvement in the nomination process, and, hopefully, we end up in a better place than we are today," Erlichman says.

Olasker says other recent trends in shareholder activism are taking some of the hostility out of the process.

"We're seeing a lot more engagement with shareholders, but it's not necessarily ripening into public contests," she says.

As a result, proxy contest statistics are becoming a less reliable measure of the level of activity from activists.

Data from Kingsdale Advisors shows a steadily increasing number of Canadian contests since 2003, barring a major spike in 2009 following the global financial crisis.

The 2015 total of 55 contests was a Canadian record, but it fell to just 38 in 2016.

"Because there are fewer of the high-profile ones, you could get the impression that disputes don't exist," Olasker says.

However, she says there's much more activity bubbling beneath the surface.

Instead of public, headline-grabbing fights, Olasker says the results of activism reveal themselves to those in the know via subtler clues.

"You might see a press release, *à propos* of nothing, that talks about refreshing the board. That's a sign that someone has been in there, hammering on the need for change," she says.

Olasker sees it as a sign of the maturation of shareholder activism since the first wave of aggressive activists came in kicking and screaming.

"The only way to get attention was to come in, spoiling for a fight," she says.

"Activists are becoming better advised, and they are prepared to engage privately before going public. Boards, too, accept that it's now part of the landscape, and other shareholders recognize that the activists can be acting in their common interest."

Trevor Zeyl, a member of Norton Rose Fulbright Canada LLP's special situations team, which focuses on shareholder disputes, says he expects the next year to bring a healthy level of activism.

He says American groups view the Canadian market as particularly attractive because of our relatively weak dollar and shorter history of activism.

"I wouldn't say the U.S. market is saturated, but there are a lot more activist firms there, and some of the mid-size ones are looking to Canada because it's a target-rich environment," Zeyl says. "There are a lot of smaller and mid-cap opportunities here that are not necessarily available in the U.S."

In addition, he says Canadian corporate laws are more attractive to activists than U.S. laws because of the lower threshold needed to requisition shareholder meetings and the ability to accumulate a larger share of a company before they are forced to disclose their plans.

In an increasing number of cases, Bell says, U.S.-based activists have even partnered with Canadian shareholders.

For example, when Connecticut-based activist FrontFour Capital Group made its move on Granite REIT, it teamed up with Vancouver private equity firm Sandpiper Group to nominate new directors for the board.

"One of the responses you will see from Canadian companies that are targeted by U.S. hedge funds is that they don't understand the Canadian market, so if we continue to see these partnerships, that is one way for them to blunt that criticism," Bell says.