ADVANCE NOTICE BY-LAWS – A TOOL TO PREVENT A STEALTH PROXY CONTEST OR AMBUSH

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On a Sunday afternoon in the Spring of 2011, the Chair of a Canadian public company sent an email to one of our colleagues requesting assistance. The Chair had received a phone call on the prior day (Saturday) from a shareholder informing the Chair that the shareholder had legally accumulated enough proxies and obtained the support of enough registered shareholders to elect his own nominees as directors at the company's shareholders' meeting scheduled for 10:00 a.m. that Monday. This call, which was made less than 48 hours prior to the shareholders' meeting, was a total surprise to our client. In fact, the shareholder did not legally have to provide any advance notice to the company or its shareholders, and could simply have stood up at the meeting and successfully nominated his slate without providing any information about his nominees, other than their names!

If our client had put in place an advance notice by-law, the ambush perpetrated upon it and its shareholders would not have been possible.

Over the course of the past several months, McMillan has advised Canadian public companies on the implementation of advance notice by-laws and, as a result, we are uniquely qualified to assist in the design and implementation of advance notice by-laws that will benefit public companies and their shareholders.

background

Advance notice by-laws have been utilized by American companies for over twenty years and are now prevalent in the United States. In the United States, advance notice by-laws generally require that advance notice of various shareholder propositions be provided to a public company, including the nomination of directors. Such by-laws are considered by Delaware courts to be "commonplace" and have frequently been upheld as valid by Delaware courts; however, where there is ambiguity in such by-law provisions, Delaware courts will interpret the provisions against the interests of the issuer.[1]

In designing advance notice by-laws in a Canadian context, we have limited their use to circumstances where nominations of persons for election to the board of directors of the issuer are made by shareholders, other than pursuant to a requisition of a meeting made in accordance with the issuer's governing legislation[2] or a

shareholder proposal made pursuant to the provisions of such legislation. Although this limitation may not be legally required, we believe that an advance notice by-law has limited utility in circumstances where shareholders have requisitioned a shareholders' meeting or submitted a shareholder proposal for the purpose of nominating directors.

In this regard, it should be noted that under the OBCA and CBCA, the following four methods would appear to be available to shareholders to nominate directors at a meeting of shareholders:

- *Shareholders' requisition*. Registered shareholders owning not less than 5% of the shares of an issuer may requisition the directors to call a meeting of shareholders (the "shareholders' requisition") for the purpose of electing directors. Subject to certain exceptions, if the directors do not call a meeting of shareholders within 21 days of receiving the shareholders' requisition, any shareholder who signed the requisition may call the meeting. The OBCA and CBCA require that notice of the time and place of a meeting of shareholders be sent not less than 21 days before the meeting.
- *Shareholder proposal*. Shareholders owning not less than 5% of the shares of an issuer may, in respect of an annual meeting, not later than, under the OBCA, 60 days before the anniversary date of the previous annual meeting (or, in respect of a special meeting, 60 days before a special meeting), and, under the CBCA, not later than 90 days before the anniversary date of the previous notice of annual meeting, submit to the issuer notice of a proposal to nominate persons for the election of directors. Upon receipt of the proposal, the issuer would be obligated, subject to certain exceptions, to set out the proposal (and, if requested, a brief statement of the shareholder in support of the proposal) in its proxy circular for the meeting or attach the proposal (and, if applicable, such shareholder statement) thereto. Accordingly, if the issuer's annual meetings are held on or after the anniversary date of the previous year's annual meeting, the issuer will have ample notice of a proposal relating to nominations for the election of directors.
- *Proxy fight*. Following the mailing of proxy materials by an issuer relating to the election of directors, any person may solicit proxies, so as to elect their own nominees to the board of the issuer, by delivering a dissident's proxy circular (or by way of public broadcast, speech or publication in circumstances prescribed by the legislation). This type of activity is generally referred to in business parlance as a proxy fight. There is no time restriction as to when one may solicit proxies through these means, subject of course to practical time constraints. As a result, a proxy fight could be commenced without much prior notice to the issuer or its shareholders.
- *Nominations at a meeting*. Shareholders or proxyholders may, at a meeting called for the purpose of electing directors, nominate from the floor of the meeting one or more persons to serve as a director. No prior notice of such nomination need be given to the issuer or its shareholders. A nomination made in

such circumstances is referred to herein as an "ambush."

Advance notice by-laws have been designed by McMillan to prevent shareholders from nominating directors through a proxy fight or an ambush, without in each case providing an issuer with adequate time to consider and respond in an informed way to such proposed nominations. Advance notice by-laws should not discourage nominations, but should instead benefit shareholders, by:

- ensuring that all shareholders – including those participating in a meeting by proxy rather than in person – receive adequate notice of the nominations;
- allowing shareholders to register an informed vote;
- facilitating an orderly and efficient meeting process; and
- preventing an ambush.

advance notice by-law provisions

The length of the notice period for advance notice by-law provisions prepared by McMillan varies but, in the case of an annual meeting of shareholders, is usually no less than 30 nor more than 65 days prior to the date of the annual meeting and, in the case of a special meeting of shareholders, no less than 15 days following the date of the public announcement of the date of the special meeting.

We note that Institutional Shareholder Services Inc. in its 2012 U.S. Proxy Voting Guidelines Summary supports advance notice by-laws "which allow shareholders to submit proposals/nominations as close to the meeting date as reasonably possible [not more than 60 days prior to the meeting] and within the broadest window possible [not less than 30 days], recognizing the need to allow sufficient notice for company, regulatory and shareholder review."[3]

In order to ensure that an issuer and its shareholders have sufficient information so that they can act prudently and in an informed manner, advance notice by-laws as prepared by McMillan stipulate that the shareholder notice provided to the issuer must include all information relating to the nominees and the shareholder making the nomination that would be required to be made in a dissident's proxy circular pursuant to the issuer's governing legislation and applicable securities laws.

In light of the fact that we expect Canadian courts to follow U.S. courts and interpret advance notice by-law provisions against the interests of an issuer, it is critical that such provisions be well drafted and be prepared in contemplation of various scenarios.

acceptance in Canada

In our experience, shareholders of Canadian public companies understand the benefits of advance notice by-

laws and are generally supportive of their adoption. It is expected that over the next few years, numerous Canadian public companies – particularly mid and micro-cap companies – will implement such by-laws.

implementation of by-law

The directors of an issuer may by resolution pass an advance notice by-law, following which the by-law must be submitted by the directors to the shareholders at the next meeting of shareholders. The advance notice by-law would be effective from the date of such directors' resolution until it is confirmed, confirmed as amended or rejected by the shareholders at the next meeting. If the advance notice by-law is confirmed or confirmed as amended at the next meeting, it would continue in effect in the form in which it was so confirmed.

If the advance notice by-law is rejected by shareholders at the next meeting, or the directors do not submit the advance notice by-law to the shareholders at the next meeting, the advance notice by-law would cease to be effective from the date of the meeting and no subsequent resolution of the directors to make, amend or repeal a by-law having substantially the same purpose or effect as the advance notice by-law would be effective until confirmed or confirmed as amended by the shareholders.

In implementing an advance notice by-law, careful consideration (including tactical matters if the meeting will be contested) should be given as to whether it should apply to the meeting at which it is to be approved. Although we recommend that an advance notice by-law not be applied to a meeting at which it is to be approved, there are tactical considerations in its initial implementation even in such circumstances.

conclusion

An advance notice by-law is an important tool for a public company in order to ensure that all shareholders are treated fairly and are provided with timely information in connection with the nomination of directors. It is expected that advance notice by-laws will in time be commonplace in Canada, especially for mid and micro-cap public companies.

If you would like more information about advance notice by-laws and our unique Canadian perspective on this matter, please contact the authors of this bulletin (listed below) or another member of our Capital Markets and M&A Group.

by Paul D. Davis and Stephen Genttner

[1] *Openwave Systems Inc v Harbinger Capital Partners Master Fund Ltd*, CA No. 2690 – VCL (Del Ch May 18, 2007) at 18 and 20.

[2] Clients of the firm that have adopted advance notice by-laws have been governed by the *Business Corporations Act* (Ontario) ("OBCA") and the *Canada Business Corporations Act* ("CBCA").

[3] 2012 U.S. Proxy Voting Guidelines Summary at 23. Online: <www.issgovernance.com/files/ISS2012USPolicySummaryGuidelines1312012.pdf>.

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.