ADVANCE NOTICE BY-LAWS, PART II – THE *MUNDORO CAPITAL* DECISION

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In March 2012, we publicly advocated the adoption of advance notice by-laws by public companies in concluding that 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."[1] During the 2012 proxy season, the boards of directors of several of McMillan's clients[2] adopted advance notice by-laws and in each case the by-laws were approved by shareholders without legal challenge.[3]

In addition to our experiences with our clients, we note another instance where advance notice provisions have been adopted. On June 11, 2012, fifteen days prior to a previously called annual meeting, Mundoro Capital Inc. ("**Mundoro**") announced that its board of directors (the "**Board**") had adopted advance notice provisions - basically identical to the form of advance notice by-laws adopted by McMillan's clients - in the form of a policy of the Board. The advance notice policy of Mundoro (the "**Policy**") was challenged quickly by Northern Minerals Investment Corp. ("**Northern**"), a shareholder of Mundoro, before the Supreme Court of British Columbia (the "**Court**"). The Court rejected the challenge and released its decision on July 20, 2012.[4] While we have some concerns with the reasoning of the Court, we believe that the decision in *Mundoro Capital* provides further support to our earlier expressed view that "advance notice by-laws will in time be commonplace in Canada, especially for mid and micro-cap public companies."[5]

background

Mundoro is a public company governed by the *Business Corporations Act* (British Columbia) (the "**Act**") whose shares are listed and posted for trading on the TSX Venture Exchange. Northern held approximately 8.4% of the outstanding common shares of Mundoro.

On April 20, 2012, Mundoro scheduled its annual shareholders' meeting for June 26, 2012, with a record date of May 22, 2012. The proxy circular for the meeting was issued on May 22, 2012, and Mundoro retained a proxy solicitation firm. On June 11, 2012, Mundoro announced that its Board had adopted the Policy on June 9, 2012, in order to set a deadline by which shareholders were required to submit nominations for persons to be elected

as directors of Mundoro.

On June 13, 2012, Northern advised Mundoro that it was of the view that there was no legal basis for the Policy and that failing a withdrawal of the Policy, Northern would seek redress from the Court. On June 14, 2012, Mundoro issued a press release postponing the annual meeting to August 27, 2012, and stating that shareholders would be asked to approve the Policy at the August 27 meeting.

The hearing on the matter was held on June 15, 2012, and before Northern's petition was dismissed[6] it disclosed, on June 18, 2012, the names of five nominees to replace the slate of directors previously put forth by Mundoro.

decision

Before the Court, Northern made the following principal arguments in support of its contention that the Policy was unenforceable:

- The Policy deprives shareholders of their right to elect directors in accordance with the Act with the result that the Board can entrench itself.
- The Policy is an attempt to interfere with the fundamental right of shareholders to elect directors, without authorization or justification.
- The Act requires that the election and removal of directors must occur in accordance with the articles.[7] Accordingly, for the Policy to be enforceable, its provisions must be part of the articles and must therefore be approved by a special resolution of the shareholders of Mundoro.

The Court rejected Northern's arguments and stated that "the *Act* and the articles give the directors the power to exercise those powers not specifically reserved to the shareholders ... and [n]either the *Act* nor the articles expressly preclude directors from creating such a Policy."[8]

The Court then went on to note that in the case before it, shareholders' rights were not being infringed:[9]

> In this case it has not been established that the Policy is one that infringes shareholder rights. Rather, the Policy in fact ensures an orderly nomination process and that the shareholders are informed in advance of an AGM what is in issue. In doing so the Policy prevents a group of shareholders from taking advantage of a poorly attended shareholders meeting to impose their slate of directors on what could be a majority of shareholders unaware of such a possibility arising.

The Court concluded by noting that although the Policy allowed the Board to waive in its sole discretion any requirement therein, such discretion can be reviewed by a court. This factor, as well as the fact that Mundoro intended to seek shareholder approval of the Policy at the annual meeting, were "evidence [of] good faith and

the reasonableness of the Policy."[10] No evidence had been put forward by Northern that the Board was not acting "reasonably."

observations

The reasoning of the Court fully supports the policy rationale for advance notice by-laws (or articles with advance notice provisions in the case of a company incorporated under the Act) in that such by-laws (or articles) prevent dissidents from hiding "in the weeds" until a shareholders' meeting and thereby "preventing all shareholders from having notice and the opportunity to vote in a proxy contest."[11]

We remain concerned, however, with the adoption of advance notice provisions by way of a board policy, and would strongly recommend that, for Ontario and federal public companies, such provisions be adopted by way of a by-law and in the case of a company incorporated under the Act that the company seek shareholder approval for the advance notice provisions by way of an amendment to the company's articles or adopt articles with advance notice provisions at the time of incorporation. The decision of a board to put in place its own rules that may in any way be considered to restrict the rights of shareholders to elect directors is fraught with danger and it would in our view be best if such rules are set out in the constating documents. In this regard, we would note that the Court considered shareholder approval of the Policy to be important. The implementation of advance notice provisions through the amendment of an issuer's constating documents should at the very least help to insulate the board of directors of the issuer from a fact-based analysis of the propriety of such provisions and the reasonableness of such provisions in each circumstance.

Notwithstanding the concern we may have with the fact that Mundoro implemented advance notice provisions through the adoption of a board policy, we are encouraged by the decision of the Court in *Mundoro Capital*. As a result, it remains our expectation that there will be a broad adoption of advance notice by-laws (articles) by Canadian mid and micro-cap public companies.

by Paul D. Davis, James Munro and Stephen Genttner

[1][ps2id id='1' target='/] Paul Davis & Stephen Genttner, "Advance Notice By-Laws – A Tool to Prevent a Stealth Proxy Contest or Ambush" (March 2012).

[2][ps2id id='2' target='/] Six of our clients have so far adopted these by-laws.

[3][ps2id id='3' target='/] However, there was one threatened legal challenge in connection with the application of a by-law to the meeting at which the by-law was to be approved; but not in connection with the legal validity of the by-law. The application of the by-law to such meeting was waived by the board of the issuer as the issuer's goal of bringing dissidents out of the "weeds" was achieved. In any event, the by-law was approved at the annual meeting of the issuer.

[4][ps2id id='4' target='/] *Northern Minerals Investment Corp v Mundoro Capital Inc*, 2012 BCSC 1090 [*Mundoro Capital*].

[5][ps2id id='5' target='/] *Supra* note 1.

[6][ps2id id='6' target='/] Northern had amended its petition to also seek an order to prevent Mundoro from postponing its annual meeting and changing the record date for such meeting. The Court also rejected those requests.

[7][ps2id id='7' target='/] Under the Act, the "notice of articles" contains prescribed information such as the company's name, names and addresses for each of the directors, registered and records office address, authorized share structure and whether there are special rights or restrictions attached to a class or series of shares. The articles of a company incorporated under the Act set out the general rules governing the company's internal affairs and the restrictions, if any, on the businesses that may be carried on by the company and the power that the company may exercise. The company adopts its notice of articles and articles at the time of incorporation and in order to amend the notice of articles or articles, as the case may be, the company's shareholders must approve (in most cases by special resolution) the amendment prior to such amendment becoming effective. Under the *Canada Business Corporations Act*, the *Business Corporations Act* (Ontario) and in most other provincial or territorial corporate statutes in Canada, the "articles of incorporation" contain prescribed information such as the corporation's name, authorized share structure, whether there are special rights or restrictions attached to a series of shares and the restrictions, if any, on the businesses that may be carried on by the corporation. The by-laws under such corporate statutes are adopted post incorporation and set out the rules of the corporation's conduct, subject only to confirmation (or rejection) by the corporation's shareholders. By-laws are roughly similar to the articles of a company incorporated under the Act but the key difference between by-laws and articles is that by-laws become effective immediately upon director approval and are subject to confirmation (or rejection) at the next meeting of shareholders by ordinary resolution whereas any amendment to the articles of a company incorporated under the Act is subject to shareholder approval (in most cases by special resolution) and the amendment is effective only upon the requisite shareholder approval being obtained.

[8][ps2id id='8' target='/] *Supra* note 4 at para 45.

[9][ps2id id='9' target='/] *Supra* note 4 at para 47.

[10][ps2id id='10' target='/] *Supra* note 4 at para 51.

[11][ps2id id='11' target='/] *Supra* note 4 at para 54.

A Cautionary Note