PROXY ACCESS IN CANADA -- ANOTHER US CORPORATE LAW PRACTICE MAKES ITS WAY UP NORTH

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An old debate in corporate law is about the role, and control, of shareholders over the managers of their companies. Some romanticise this notion and call it "shareholder democracy"--no doubt, inspired by goings on in the political realm. The latest iteration of this debate is called "proxy access". On March 30, 2017, at the annual meeting of TD Bank, the first ever shareholder proposal on adoption of a proxy access bylaw in Canada was passed. The following week, RBC also put for vote a similar proposal but it narrowly failed. South of the border, last month, Nike and IBM became the latest public companies to go down the road of proxy access.

Proxy access allows certain shareholders the right to make their own director nominations and have those director nominees featured on management proxies. TD, for instance, will now be required to adopt proxy access bylaws that will mandate it to publish the names of the shareholder nominees for directors in its proxy circular and proxy cards.

Current Law

In the absence of proxy access in Canada, a registered shareholder has two ways to solicit proxies for shareholders and board nominees. First, a shareholder can nominate individuals, after complying with any advance notice provisions, and solicit proxies with a dissident circular or news release. Second, the "proposal" method under corporate statutes, more or less, provides a shareholder holding at least 5% of the voting shares with the right to require management to include the shareholder nominees in the management proxy circular. The broad adoption of proxy access by-laws could add a third method for direct shareholder participation in director nominations. Indeed, the TD and RBC proposals arrive coincidentally with the recently proposed amendments to the Ontario Business Corporations Act that, if passed, would allow registered or beneficial shareholders holding at least 3% of the shares, after complying with the proposal provisions, to nominate a single person for election as a director and have the corporation's proxy card include such nominee.

Whether proposed amendments will be approved remains to be seen. In the US, in 2010, the SEC introduced amendments to the proxy rules under the Exchange Act (also called the "3/3/25 Rule") that gave shareholders

who: (i) owned at least 3% (individually or as a group) of the company's securities entitled to be voted, (ii) for at least 3 years, (iii) to nominate up to 25% of the company's directors. After inevitable litigation, the SEC softened its stance and permitted companies to adopt proxy access bylaws of their own accord. According to one study, more than 50% of S&P 500 companies have now adopted proxy access provisions.

Support from Shareholder Groups

Proponents of proxy access, such as the Canadian Coalition for Good Governance, an influential body of institutional investors, encourage issuers to take measures to enhance "proxy access" to increase the ability of shareholders to have meaningful input into the director nomination process. Supporters also argue that proxy access lowers the costs of an election contest as shareholders no longer have to undertake a costly proxy solicitation campaign. Currently, under Canadian securities laws if proxy solicitation is made to more than 15 shareholders a dissident circular must be provided to shareholders. Proxy advisors such as Institutional Shareholder Services, Inc. (ISS) support proxy access "as an important shareholder right, one that is complementary to other best-practice corporate governance features." Not surprisingly, ISS supported both the TD and RBC proposals.

No Shortage of Critics

Critics have also put forward their own arguments. One, they argue that the current law already provides sufficient access for shareholders. For instance, they point to the proposal method (stated above) for inclusion of shareholder nominees in the proxy circular. Two, they argue most director nominees are already selected by independent and opposing board committees. Three, they argue that proxy access does not fully promote shareholder democracy--the number of nominees a shareholder can propose is limited and garnering requisite shareholder support to gain a seat is remote without a prolonged promotional campaign. Four, US practice shows that many institutional investors have not yet made significant use of proxy access. Apparently, many activist investors who could benefit from proxy access, fail to meet the three year holding period requirements. Finally, somewhat ironically, some argue that director election will continue to be a rigged game as management will still control the design of the proxies and disclosure materials. Other commentators caution against the balkanization of boards with nominees lacking a consistent corporate vision.

Future of Proxy Access in Canada?

Kingsdale Advisors, in a recent report, said that "proxy access [will be an] inevitability in the near future". If so, can we expect a suite of defensive measures as incumbent boards seek to maintain the status quo? Corporate law scholar J.W. Verret has proposed a number of defensive tactics for incumbent boards, including measures such as making dividends (even the grant of a single dividend) contingent upon no shareholder-nominees, withholding director and officer insurance from shareholder nominees, and shareholder nominee qualification

bylaws. If the US practice is any guide, it appears few of these measures will be adopted.

It is no secret that the influence of US governance standards on Canadian firms is strong. The list of policies that have made their way north is extensive while we should perhaps expect proxy access to join such ranks, we expect acceptance of proxy access to be accompanied by an animated debate on both sides of the aisle. On the one hand, management will have to consider providing equal treatment for the shareholder nominees, including commensurate disclosure in the circular on essentially the same terms as its nominees. On the other hand, shareholder groups will have to balance their demands for greater proxy access against its impact on firm value.

Steering between Scylla and Charybdis is not easy. Companies that provide excessive concessions may end up struggling to reconcile diverging viewpoints; and, others that press for overkill in the way of defensive tactics may embitter shareholder relations and, in doing so, lay the groundwork for a proxy contest or shareholder defection. Fortunately, the US experience may point us to a path forward.

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A Cautionary Note