HANSELL LLP

Advance Notice By-Laws

Considerations for Shareholders

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In the 2014 proxy season, shareholders of a number of Canadian public companies are being asked to approve advance notice by-laws.

Advance notice by-laws have been a governance trend in Canada since 2012, advocated by many as an important protection for shareholder democracy in the context of a proxy battle. Shareholders should look more closely.

What is the purpose of advance notice by-laws?

An advance notice by-law prevents a dissident from nominating a candidate for election to the board, unless that shareholder submits certain information to management in advance of the deadline set out in the by-law (subject to certain exceptions).[1] This prevents management from being taken off guard by a dissident and gives management time to respond to the dissident action.

What prompted Canadian issuers to start adopting advance notice by-laws.

Advance notice by-laws are common in the United States, but until very recently did not attract much attention in Canada. The trend in adopting these by-laws in Canada began in the mining sector. With share value down as a result of low commodity prices, opportunistic investors saw the chance to take a position in an issuer and gain control of the board. Shortly before an annual meeting, they would announce that they were nominating their own candidates for the board and that they had enough votes to carry the day. This is referred to as "ambushing" the annual meeting. While this would be very difficult to do in a widely held company, it is feasible with a small public company, particularly where shareholder participation in meetings is low. Examples of meetings being ambushed include the QLT meeting in 2012 and the Midland Minerals meeting in 2011.

Advance notice by-laws (advance notice policies in British Columbia) survived court challenges in BC and Ontario in 2012. In the first of these decisions (the *Mundoro* decision[2]), the court

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1 Shareholders of Canadian companies have the right to submit a proposal nominating a director and have a supporting statement about the nominee included in the management's information circular. They are also able to requisition a meeting to remove and elect directors. Advance notice bylaws do not (and legally could not) restrict either of those rights.

2 *Northern Minerals Investment Corp. v. Mundoro Capital Inc.*, 2012 BCSC 1090.

noted with approval the "good faith and reasonableness" of the policy. In 2013, there was an explosion of issuers adopting these by-laws and policies. In June 2013, 90% of the issuers with advance notice by-laws in place had adopted them in that year.[3] The trend is continuing into 2014, but with large issuers joining in. Air Canada, Barrick and Sherritt International all put advance notice by-laws before their shareholders for approval this year (in some cases applying them to dissident nominations in the mean time).

What specifically does an advance notice by-law require?

Advance notice by-laws set out certain requirements that a dissident must satisfy in order to nominate candidates for election to the board (other than by way of a proposal or by requisitioning a special meeting).

Under the form of advance notice by-law being put to shareholders in this proxy season, dissidents are required to make certain disclosure to management about the dissident and its nominees prior to a specified date. The information must be in the specified form (in some cases using a form that the dissident must obtain from the issuer). The dissident may be required to update the information as at 10 business days prior to the date of the meeting and may be required to provide additional information about the nominees as the issuer may reasonably require. The dissident's nominees may also be required to meet with the nominating and governance committee of the board (or its equivalent). Failure to comply with the provisions of the advance notice by-law will result in the nominee not being eligible to serve as a director. The board is entitled to waive any of the requirements of the by-law.

The disclosure requirements set out in advance notice by-laws largely follow the information required to be disclosed in a dissident's proxy circular in connection with solicitations of proxies for election of directors. One notable departure from corporate and securities laws is that the by-laws require a nominating shareholder to provide additional information regarding the acquisition of the issuer's securities, including providing full particulars of any arrangements, such as derivatives or securities lending arrangements, that have the purpose or effect to alter the shareholder's the economic interest in the issuer. Circumstances where shareholders have used interests in derivatives as a way to avoid reporting requirements were raised in recent court decisions in Delaware[4] and British Columbia[5]. Even as TELUS Corporation was engaged in litigation with Mason Capital over Mason's Capital's efforts to influence the outcome of a TELUS shareholder vote with "empty votes", Mason Capital had begun to unwind its position, unbeknownst to TELUS and to the court. This fact would have been relevant to TELUS's

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3 CST Phoenix Advisors, *Client Update: Proxy Season Preview* (2014) at 12.

4 *CSX Corp v Children's Investment Fund Management (UK) LLP* (2d Cir 2011).

5 *TELUS Corporation v. Mason Capital Management LLC,* (2012) BCCA 403 ("*TELUS*").

arguments in those proceedings.[6] Courts that have considered the problem of interests hidden through derivative positions have found that the remedy for additional transparency must lie in legislative and regulatory change[7], including amendments to the early warning reporting regime.

Changes in early warning disclosure are under consideration in Canada, but have been controversial.[8] Issuers are now turning to private means of compelling the disclosure they believe is necessary through the adoption of advance notice by-laws.

Are advance notice by-laws good or bad for shareholders?

The line of sight that advance notice by-laws provide into the nature of a dissident's interest in the corporation allows management to better assess the potential motives of the dissident and the impact that the dissident could have on corporate actions. Where those motives do not align with the interests of the corporation (as many believe was the case in the TELUS/Mason Capital battle), this disclosure is very much in the interests of shareholders.

Shareholders will also see the merits of preventing a dissident ambush at an annual meeting. However, an ambush is only practical as a dissident tactic where the shares are held in such a way that a dissident could solicit enough proxies to carry a meeting without being required to issue a dissident circular. In most cases (and certainly in the case of a widely held company) dissidents conduct a broad solicitation of proxies and, in connection with that solicitation, issue a dissident circular. The effect of an advance notice by-law in these circumstances is in part to provide to management, earlier in the process, the information that shareholders will ultimately receive in the dissident circular. More importantly, advance notice by-laws typically give management an open-ended right to demand additional information from the dissident and to determine when it is satisfied that the dissident nominees may stand for election.

Shareholders should be wary of the ability of management and the board to use an advance notice by-law as a defensive tactic. Strict application of the provisions of most advance notice by-laws could allow an issuer's board and management to frustrate the efforts of a dissident to

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6 See TELUS's Response to the Canadian Securities Administrators' Notice and Request for Comments to Proposed Amendments to Multilateral Instrument 62-104, National Instrument 62-203 and National Policy 62-103 (July 2, 2013).

7 *TELUS*, *supra* at para. 81.

8 The Canadian Securities Administrators ("CSA") published a number of proposed changes to the early warning reporting regime in March 2013 (the "Proposals"). Among the changes published for comment, the Proposals would require additional transparency by including equity equivalent derivatives and securities transferred under lending arrangements. The Proposals have received a number of comments from the issuer and investor community and, at this time, it is uncertain whether any of these changes will be implemented. See *CSA Notice and Request for Comment Proposed Amendments to National Instrument 62-103 Early Warning System and Related Take-over Bid and Insider Reporting Issues* (2013) 36 O.S.C.B. 2675.

put legitimate alternatives before the shareholders. The board is entitled to waive the provisions of advance notice by-laws in most cases, but is not obliged to report to shareholders about the reasons that the by-law has been applied or waived. The application of advance notice by-laws has been litigated in the US. In a 2012 decision, Leo Strine (now the Chief Justice of Delaware) noted that "[a]dvance notice bylaws have long been a controversial thing", and questioned whether a corporate board "can hide behind the advance notice bylaw" in order to manage the process for director elections.[9] Shareholders that have complied in good faith with the by-law should expect that management engage with the shareholder or advise that the nominees have complied with the requirements within a reasonable time period.

Shareholders should also appreciate that advance notice by-laws are not a vehicle for providing information to shareholders. In fact, most advance notice by-laws specifically provide that neither the issuer nor the board is required to disclose to shareholders any of the information provided to it by a dissident in accordance with the by-law.

Finally, shareholders should understand that the fact that a dissident has provided information about its nominees to the issuer's board does not mean that the board will reconsider its own nominees. In the Sherritt proxy battle, for example, the company issued its management information circular before the deadline for nominations under its advance notice by-laws had even expired.[10] Sherritt would have known that nominees could have come forward after its circular had been released. According to the dissident's public disclosure, it advised Sherritt that it would be putting forward nominees in accordance with the advance notice by-laws, but Sherritt nevertheless issued its circular before the deadline.

Conclusion

Shareholders should look critically at the advance notice by-laws they are being asked to approve. ISS and Glass Lewis have both adopted policies against which they review such by-laws. ISS will generally support proposals to adopt an advance notice by-law where the company's deadline is reasonable (not more than 65 days and not less than 30 in most cases) and disclosure requirements not unduly onerous. ISS will generally vote against adoption of a by-law if the board may waive only a portion of its provisions or if the by-law requires proposed nominees to deliver written agreements that they will comply with the company's director

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9 *HealthCor Management v Allscripts Healthcare Solutions* (Del Ch, 25 May 2012). Concerns with advance notice by-laws were identified as early as *Schnell v Chris-Craft*, 285 A2d 437 (Del 1971). See also *JANA Master Fund Ltd v CNET Networks Inc* (Del Ch, 13 March 2008); *Levitt Corp v Office Depot Inc* (Del Ch, 14 April 2008).

10 Hansell LLP is acting for Clarke Inc., the dissident in the Sherritt proxy contest.

policies and guidelines.[11] Glass Lewis will generally support an advance notice by-law "so long as the terms are reasonable and not unduly restrictive for shareholders".[12]

Once an advance notice by-law is in place, shareholders should also demand accountability from management and the board on the way in which by-law has been applied. Management will never prefer a dissident nominee, but shareholders sometimes will.

The information and views set out above are a general discussion of certain legal and related issues and should not be relied upon as legal advice or opinions in relation to any particular circumstances. If you require legal advice, please feel free to contact us and we would be pleased to discuss these issues with you further.

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11 ISS, *Canadian Corporate Governance Policy: 2014 Updates* (21 November 2013), at 12-13.

12 Glass Lewis & Co, *Proxy Paper Guidelines: 2014 Proxy Season. An Overview of the Glass Lewis Approach to Proxy Advice. Canada* (2014), at 29.