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Advance notice provisions on the rise

An increasing number of Canadian companies are trying to avoid being ambushed with last-minute director nominations

BY Janet McFarland

Canadian companies have adopted an avalanche of provisions in the past year requiring dissident shareholders to give them advance notice before they nominate new directors for their boards, raising concerns among some shareholder advocates that the rules could make it more difficult to launch battles to replace directors.

In 2012 and so far in 2013, 560 Canadian companies have adopted or announced so-called advance notice provisions, typically requiring shareholders to give them at least 30 days notice before their annual meetings of any director nominees they intend to propose for election from the floor at an annual meeting, according to a review by Toronto law firm McMillan LLP.

Paul Davis, a lawyer with McMillan LLP, says shareholder activism has led many companies to introduce new proxy rules. FRED LUM *The Globe and Mail*

Almost 60 per cent of the firms are listed on the TSX Venture exchange – many of them in the mining sector – and fear being "ambushed" with last-minute director nominations in an era of growing shareholder activism, says McMillan lawyer Paul Davis.

"In the mid-cap and micro-cap space, there were historic numbers of proxy fights, so people simply became aware of these issues," Mr. Davis said. "And it just took off ... We were shocked at the number."

Stephen Griggs, a governance advocate who now heads activist small-cap investment firm Smoothwater Capital Corp., said he does not like the new provisions because companies can wait until 21 days before their annual meeting to send out proxy circulars to shareholders announcing their intended board nominees.

If dissidents must declare their plans to nominate directors at least 30 days before the meeting, it means they can-

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not always wait to see who the company is proposing first. The time gap can be important in cases where shareholders have been urging the company to make board changes and have been waiting to see the company's response.

Mr. Griggs says the advance notice provisions should simply require shareholders to put out a press release five or 10 business days before the annual meeting announcing information about alternative directors they will nominate at the meeting.

"That's reasonable and that avoids an ambush," Mr. Griggs said. "Why has all this other stuff crept into these bylaws? I'd argue that it's trying to create tactical advantages for the incumbent board."

Shareholders often propose new nominees for a board using a dissident proxy circular sent to shareholders, which typically provides plenty of formal notice to the company and other investors that a proxy battle is at hand. The new provisions apply to a lesser-used method, allowing shareholders to nominate directors from the floor at an annual meeting without advance notice.

That method is rare at meetings of large companies because it is extremely difficult to line up adequate voting support from other shareholders without advance notice. But smaller firms could be vulnerable if they have fewer shareholders who can organize to put their votes behind a last-minute nomination.

The trend took off in earnest in Canada in 2012 after the B.C. Supreme Court received an application to overturn an advance notice provision adopted by Mundoro Capital Inc., ruling the protections were reasonable. The practice got a further boost last November, when influential proxy advisory firms ISS and Glass Lewis said they would support advance notice proposals in 2013.

Lawyer Andrew MacDougall from Osler LLP, who has helped companies draft notice provisions, says the provisions have so far been upheld by courts in B.C. and Ontario, but he anticipates future court challenges if companies add extra hurdles beyond legal norms.

For example, he said some companies have asked for information about proposed director nominees that go beyond the details required to be included in proxy circulars – such as information about their total securities holdings including derivative exposures, or extra details about their arrangements or conflicts of interest.

"As long as the company is in the bounds of reason, it should be possible [for shareholders] to comply and it shouldn't impede any shareholders from acting on their rights," Mr. MacDougall said.

York University law professor Richard Leblanc said he is disturbed about the small number of cases where companies have adopted the provisions as board policies without ever putting them to a vote of shareholders, which he said is fundamentally unfair – especially when the provisions contain unusual terms.

"Lawyers can draft policies that sound good on their face, but once you peel back the onion it can serve to entrench the board," he said.

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