MORROW SODALI 50 YEARS 1972-2022

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# UPCOMING CBCA CHANGES

## PROXY IMPLICATIONS AND CONSIDERATIONS

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Dating back to 2018 when Bill C-25 received Royal Assent, certain long-awaited revisions to the Canada Business Corporation Act ("CBCA") will take effect on August 31, 2022.

A key change relates to the way directors are elected at CBCA incorporated companies. No longer will shareholders choose between 'for' and 'withhold' when electing directors. The amendments seek to implement "true majority voting" in uncontested director elections and so going forward shareholders will now choose between 'for' and 'against' on director nominees (at least in theory and more on that later). Only directors receiving a majority of the votes cast in their favour will be elected. This runs contrary to the current regime whereby directors are elected by a plurality voting standard where even a single 'for' vote enables a director to be elected.

While plurality has always been the corporate practice, the Toronto Stock Exchange ("TSX") had already adopted a majority voting policy requiring directors to tender their resignations when failing to be elected by a majority of the votes cast. Importantly, the CBCA amendments could very well eliminate a loophole for TSX issuers whereby directors required to resign in accordance with the TSX majority voting policy are in some cases allowed to stay due to exceptional circumstances. The CBCA rules provide limited and defined circumstances where directors who are not elected by a majority of votes could be re-appointed. While the TSX has yet to comment on the CBCA amendments, it might be expected that the exchange would eventually provide additional clarity on this matter to address the duplicative nature of the two sets of rules.

Issuers governed by the CBCA should pay close attention to how the revisions could have practical implications on their AGM process. From a proxy and corporate governance perspective, there are several additional considerations which we explore below.

## FORM OF PROXY CONSIDERATIONS

Due to existing Canadian securities laws which require proxies to include 'for' and 'withhold' options, the soon to be effective CBCA amendments requiring directors to be elected based on 'for' and 'against' votes will create ambiguity for issuers when creating proxies for their upcoming AGMs. While Canadian securities laws do address the potential discrepancy by exempting this requirement if the issuer complies with the requirements of the laws

relating to the solicitation of proxies under which the reporting issuer is incorporated, organized, or continued, until the Canadian Securities Administrators ("CSA") provide more clarity on whether the exemption applies to the CBCA, we anticipate there will be a heterogeneous application from CBCA companies in the upcoming proxy season where some issuers would opt to include 'for' and 'against' options only while others may also include 'withhold' as an option for the election of directors. Issuers should carefully consider what consequences, if any, would arise from the inclusion of various options and should an issuer opt to include both 'withhold' and 'against' options in their proxies, extra effort via shareholder communications should be considered to ensure shareholders are not confused. While the spirit of majority voting would dictate that 'withhold' and 'against' should mean the same thing, the inclusion of both 'against' and 'withhold' options may create the possibility whereby directors are elected based on 'for' votes exceeding 'against' votes but not 'against' and 'withheld' votes in aggregate. To prevent ambiguity in such circumstances, well crafted language in the information circular disclosing the effects of 'against' and 'withhold' votes as it pertains to majority voting will be critical. We believe in cases where issuers rely on opportunistic applications of the definition of majority voting, it is likely (although not certain) that proxy advisors would step in and issue adverse recommendations for corporate governance committee members in order to uphold the spirit of majority voting and prevent gamesmanship based on technicalities.

## HEIGHTENED RISK OF 'JUST-SAY-NO' CAMPAIGNS AT NON-TSX ISSUERS

Whereas previously, majority voting only applied to TSX-listed issuers and voluntary adopters of majority voting policies, the CBCA amendments would bring majority voting to distributing companies governed by the CBCA irrespective of their listing. The expansion of majority voting to companies outside the TSX is intended to strengthen shareholder democracy and it means that votes against directors will now be impactful on whether a director is elected across marketplaces and regardless of issuer size or sophistication. Historically, disgruntled shareholders of non-TSX listed issuers had to resort to expensive proxy contests to effect meaningful changes to a company's board. Going forward, those shareholders can now rely on a relatively cost-effective 'Just-Say-No' or 'against' campaign to express their displeasure towards company directors. This type of shareholder activism can be extremely effective and unfortunately, issuers and their boards may have no idea of what is to come. From experience, non-TSX companies often have low quorum thresholds and correspondingly low voter turnout. Under the amendments, a shareholder holding a small percentage stake at a junior company on the TSX Venture Exchange may very well be able to effect change as a result of majority voting if turnout is low enough, as is often the case. While dissidents may not be able to obtain seats, they may be able remove incumbents by ensuring they are not elected. And, unlike the "exceptional circumstances" mechanisms of the TSX majority voting policies, under the CBCA version of majority voting there is little leeway in re-appointing a director who had not met the requisite majority to be elected. In light of the upcoming amendments, CBCA companies at various venture exchanges, especially those with perceived or real vulnerabilities as it comes to performance, should be on high alert for this new type of shareholder activism. Corporate preparedness and activism defense should promptly be added to the board meeting agenda and affected issuers should seriously consider proactively upping the ante when it comes to shareholder outreach and communications so as to prevent stealth 'against' attacks. Consideration should also be given as to what level of quorum is appropriate, and whether regular shareholder engagement should play a role at every AGM, regardless of the resolutions considered or the company's size and scale. From a practical perspective, vote result disclosures are not required at companies outside the TSX. There is a real question of how companies are kept honest if they are not required to disclose their vote results and how shareholders would be able to ensure that their 'against' votes were actually counted. Consequently, we believe there will be pressure for various exchanges to modernize their rules to require issuers to disclose vote results, similar to the TSX.

## CONTESTED MEETING CONSIDERATIONS

While the CBCA amendments apply to uncontested meetings, the changes may have certain implications in the context of a contested meeting. Firstly, the mere possibility of including 'for', 'against', and 'withhold' options for proxies in contested meetings could spur unintended consequences and confusion, although it remains to be seen as to what effect, if any, would 'against' versus 'withhold' votes have on a contested election of directors. Strategic considerations related to the design of the proxy card should always be carefully considered and

thoroughly discussed, alongside advisors, when issuers are faced with a proxy contest. Furthermore, there may be instances where majority voting could be used for entrenchment under the right circumstances. It is important to note that majority voting under the CBCA is not intended to apply to contested meetings and that the CBCA defines uncontested meetings as a meeting where one candidate is nominated for each position available on the board. This may mean that in select proxy contests where dissidents run a short slate and incumbents know that they are losing a close vote by a relatively small margin, management can opportunistically increase the board size (if its constating documents so allow) to accommodate their own incumbents plus the dissident's nominees in order for majority voting rules to apply given then the number of seats would then be equal to the number of nominees up for election. Under these circumstances, majority voting may be used cunningly to exclude certain dissident directors from being elected despite having won the 'beauty contest' in a proxy fight, particularly in cases of short slates. In contested meetings, it is theoretically possible for individual directors to be elected through plurality voting even thought they lack a majority of votes cast. For illustration, in the case of Canadian Pacific Railway Ltd.'s contested meeting held on May 17, 2012 against Pershing Square Capital Management, nine of the sixteen directors elected (all of them management incumbents) had won the 'beauty contest' having won the plurality vote in favour of their election but had support levels below 50% in terms of 'for' and 'withheld' votes. This demonstrates that in a contest, nominees (either dissident or incumbents) may be elected without majority support. And if it is in the case of dissidents, there may be the opportunity for management entrenchment through the majority voting mechanism. This is further complicated by the fact that votes may be spread between 'against' and 'withhold' options from the two contending proxy cards, further creating potential ambiguity as to how majority voting should be applied in this theoretical scenario.

With the heightened risk of 'against' campaigns at various CBCA companies outside the TSX, identifying, engaging, and knowing one's shareholders will be more important than ever. At the time of writing, it is unclear as to whether other jurisdictions outside the CBCA would adopt similar changes to the amendments. We anticipate that at least some CBCA companies not listed on the TSX may consider continuing into another jurisdiction to avoid the majority voting standard. However, we caution that it remains to be seen how proxy advisors would opine on such instances where a company chooses to re-domicile to another jurisdiction where majority voting is not a requirement. At least from the perspective of Institutional Shareholder Services Inc. ("ISS"), where a continuance is sought in another jurisdiction, ISS has always historically compared the governance profile and provisions between the two jurisdictions when casting voting recommendations. Given the importance of majority voting to shareholder democracy, it is not far-fetched, at least from our perspective, that the proxy advisors may consider such changes in jurisdictions to be unsupportable absent other compelling reasons – only time will tell how the proxy advisors will react. But it remains to be seen whether proxy advisor recommendations actually matter to CBCA companies outside of the TSX given their typical low influence in a largely retail shareholder base. Issuers should holistically consider the pros and cons of any continuance decision based on their specific circumstances, hopefully alongside their advisors, before deciding on how best to proceed.



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