OPINION

# Law firm's new measure against activist investors waters down shareholder rights

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Bank buildings are photographed in Toronto's financial district on June 27, 2018. THE CANADIAN PRESS/ Tijana Martin

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A recent model bylaw for companies proposed by law firm Norton Rose Fulbright Canada purports to close a loophole resulting from last year's amendment to the Canada Business Corporation Act. It's a loophole that, as the law firm sees it, allows activist investors to carry out "sneak attacks" on companies and their unsuspecting shareholders.

However, the real sneak attack investors should be worried about is the law firm's attempt to water down hard-won shareholder rights.

Canadian investors fought for more than 15 years for their rights in uncontested director elections, in which a company's nominees for the board face no rival candidates. In cases where investors do not accept these nominees, they want to have their "against" votes be binding and free from discretionary director oversight – to ensure that, rightfully, a company's nominees do not sail through simply because there are no challengers.

The fight culminated in the CBCA amendment that did just that, which apparently is causing such distress to certain lawyers.

Under the law firm's proposed bylaw, an automatic 45-day postponement of an annual general meeting occurs if the number of votes against a director crosses a certain threshold, which could be as low as 25 per cent, giving the company additional time to try to remedy the situation.

For example, management could supplement its disclosure beyond what has been provided in the proxy circular – a document that accompanies every AGM and is the primary source of issuer/shareholder communication – and engage more with shareholders.

The purpose would be either to convince them of the perceived error of their votes or, in cases where a shareholder hasn't cast a ballot, the importance of voting. The time gives the issuer additional means to thwart any activist campaign in progress against any one or more of the directors.

The only time the postponement doesn't kick in is if the activist meets a series of onerous disclosure conditions, set out by the company in the bylaw.

It is important to note, however, that if the threshold is met the bylaw imposes the postponement regardless of whether there is an activist campaign, stealth or otherwise, in the offing. If shareholders vote against a director in the ordinary course and not under the influence of some nefarious activist, the issuer still gets time to try to change their minds. Other efforts could include retaining proxy solicitors (companies that specialize in helping management find votes) – an expensive proposition ultimately paid for by shareholders.

In essence, the bylaw has the potential to make every uncontested election a contested one. In situations where there is no fight for board seats, and shareholders are simply voting against a candidate they don't want, the bylaw gives the board the opportunity to turn it into a fight.

It's worth pointing out that companies have the opportunity and the right to convince shareholders at length in the proxy circular of the merits of the director nominees and the rationale behind their nominations. Companies also have the right – some would say more of an obligation – to engage with shareholders on a regular basis, so that they won't be blindsided by election results.

The model bylaw by Norton Rose is vulnerable to the "slippery slope" argument. Why would postponing a shareholders meeting not be appropriate/desirable in every case where the company, its management and board dislike the results of the shareholder vote? More time and ability to change shareholders' minds or persuade them to vote will always be appealing to companies faced with opposition.

Under the model bylaw, directors have the discretion to remove the automatic postponement if they believe doing so accords with their fiduciary duty to act in the best interests of the corporation. The problem, however, is that the CBCA intentionally removed director discretion in elections where shareholders have made their views clear, and the justification for reintroducing it across the board has not been satisfactorily supported. Seven stealth activist campaigns over a one-year period – in which thousands of AGMs took place – is not enough evidence of a threat necessitating watering down shareholder voting power in the ordinary course.

Companies also always have the right under existing law to postpone an AGM. But by making the postponement automatic, it reverses the onus: The directors do not have to defend the decision from criticism.

Even giving those behind the proposal the benefit of the doubt – that it is not a rearguard action to reverse the progress toward true majority voting represented by the CBCA amendment – the model bylaw overreaches by a long shot. If the objective is to stop under-the-radar activist attempts to change a company's direction without full knowledge and approval of the majority of shareholders, the bylaw needs to be redrafted and rethought so that it captures only those set of circumstances, and does not interfere with meaningful shareholder democracy.

As it stands now, far from furthering shareholder transparency, shareholder protection and democracy as its proponents claim, the model bylaw has the effect of delaying the express wishes of shareholders with respect to directors.

Investors can be expected to react negatively to attempts to turn back the clock on shareholder rights, and issuers and their directors are likely to face strong pushback when shareholders are asked to approve the model bylaw.