KINGSDALE Advisors

PROXY SEASON REVIEW 2017

SUCCEEDING IN THE NEW PARADIGM OF CORPORATE GOVERNANCE

Kingsdale Advisors' highlights of this year's proxy season, important developments in governance, and trends that will matter in 2018.

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SEPTEMBER 2017

At Kingsdale, we've established ourselves as the number one strategic shareholder advisory firm by consistently delivering the best service and unparalleled results for our clients. To ensure this foundation for success remains strong, we are continuously challenging ourselves to raise the bar and innovate. For us, winning is everything.

After each proxy season, we take time to review the landscape, ask tough questions about what the latest developments mean for our clients, and identify trends before they are trends. This means carefully observing and analyzing market changes; setting governance best practices; exploring what the latest activist techniques will mean; reflecting on successful proxy fight strategies; and forecasting the direction proxy advisors will go in so that when you hire us, together we'll be ready for anything.

Our commitment to identifying and solving unforeseen challenges has made Kingsdale more than just a proxy solicitor. We are a trusted strategic advisor to management and boards on everything from governance to executive compensation to shareholder activism to M&A to strategic communications. As part of our drive to build our global brand, we recently named Michael Fein as Executive Vice President, Head of U.S. Operations, to lead our New York office. Michael was most recently a Senior Managing Director at Okapi Partners LLC where he played key roles on numerous high-profile proxy contests and contested M&A transactions. In addition, we have further solidified our position as the leading proxy specialist by growing our team of dedicated governance professionals with the addition of Victor Guo, Executive Vice President, Governance Special Situations. Victor joins us from Institutional Shareholder Services where he was Vice President of M&A and Proxy Contest Research for the U.S. and Canadian special situations research teams. Throughout this publication, you will see governance take centre stage, reflecting its growing importance to both issuers and shareholders.

Last year, we identified a number of key issues and made predictions to the benefit of our clients:

- In our 2016 report, we warned about the growing stratification of activist types, specifically the rise of the 'constructivist'. As predicted, this year saw activists willing to negotiate behind closed doors, leading to a slight decline in the number of public proxy contests – read more about it on page 5.
- Last year, we suspected proxy advisors, particularly ISS, were poised to become more stringent on say-on-pay votes and provided some tips about how to avoid a negative recommendation. 2017 has seen ISS and Glass Lewis recommend against 18 (a record high) and 12 say-on-pay votes respectively – read more about our say-on-pay study on page 10.
- We placed a big emphasis, as we do every year, on the need to engage shareholders. For those who did, you will notice an increasing focus on environmental, social, and governance (ESG) issues in governance circles. In response to that, on page 21, we provide you with key ESG trends you need to be aware of and what you can do to make sure you are prepared to meet changing expectations.
- As with the rise of the 'reluctavists' we mentioned last year – that is, those shareholders who adopt an activist stance as a last resort – traditionally passive investors have become more active, presenting a new dynamic issuers cannot ignore – read more about it on page 27.

We hope you find this report useful as you plan ahead and prepare for the most unexpected challenges. As always, we view this report as the start of a conversation. We remain on standby, ready to help when you need us the most.

Best regards,

Wes Hall, ICD.D
Executive Chairman & Founder

Amy Freedman
Chief Executive Officer

PROXY SEASON REVIEW

section

01.

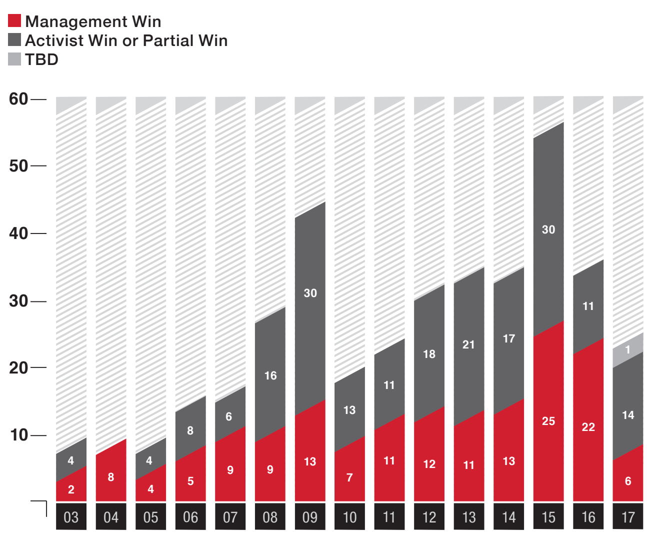
PROXY CONTEST OVERVIEW

Despite a drop in *public* proxy fights, activism remains hot – activists just keep on rolling.

More than halfway through the year, public proxy fight activity has cooled somewhat, at least relative to 2015. While 2015 remains the high-water mark for public activist campaigns, with 55, and 2016 was a busy year, with 33, the 21 public campaigns so far in 2017 show activism is a persistent investment style and a continued threat to public companies.

It is important to note that public activism is not always the goal nor the result. Companies and activists are finding new ways to work more constructively behind the scenes to realize what both hope to be value-enhancing solutions, while saving public reputations and corporate funds.

Number of Proxy Contests in Canada (2003–Present)



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All dollar figures are expressed in Canadian dollars unless otherwise specified. Some percentage charts may not sum to 100% due to rounding.

What Counts as a Proxy Fight?

We take a very comprehensive view as to what is considered a proxy fight, as only a small number of activist actions see a circular mailed and an even smaller number actually go to a meeting.

We consider a proxy fight to have been initiated when an activist shareholder (or group of shareholders), in opposition to management, makes a public filing of its activist intent, requisitions a shareholder meeting, publicly announces an intention to nominate alternate directors, solicits alternative proxies, conducts a 'vote no' campaign, or announces the intention to launch a hostile takeover bid, regardless of whether a vote or the hostile bid actually takes place, as long as the opposition is publicly known.

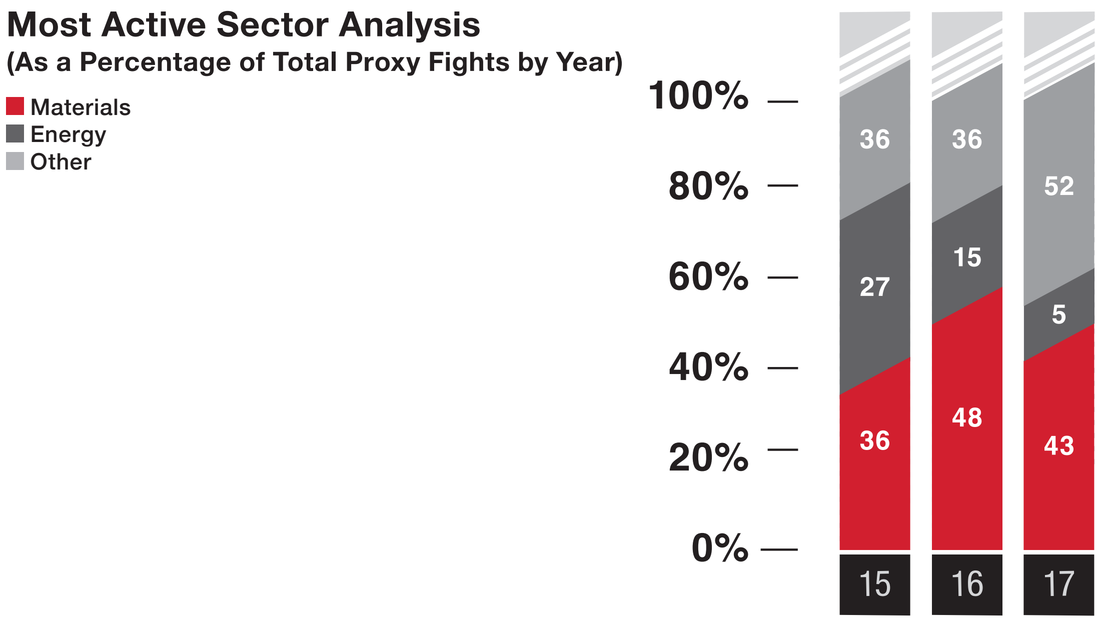
Our proxy contest data captures the campaigns that served as a tool to drive change for activists seeking board representation, changing board composition, catalyzing changes in strategy or in capital allocation, urging a sale or break-up of the company or other value-enhancing transactions, blocking a board-approved transaction, or making a hostile bid, among other dissenting actions.

Beyond being able to only report on what is public, from an anecdotal perspective, we observe three things. First, companies are becoming increasingly well defended within the Canadian landscape which makes it more difficult to identify good targets for activists to launch campaigns at.

Second, for both activists and issuers the default position is no longer going to war, with more opting for diplomacy rather than a full-fledged proxy contest.

Third, energy and mining companies, which make up the bulk of the Canadian economy and previous years' proxy fight numbers, are less appealing to short-term investors in the current market. Activists don't want to control a company when their best efforts at value creation can be quickly undercut by falling commodity prices and such prices limit the number of levers they can pull to extract value. That said, if an asset is undervalued due to bad management, activists may enter to focus on balance sheet restructuring or a transaction.

Most Active Sector Analysis
(As a Percentage of Total Proxy Fights by Year)



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As suggested earlier, the continued decline in energy sector activity in 2017 as a percentage of all campaigns has impacted the overall level of shareholder activism. Whereas the energy sector represented a sizable chunk of activity in 2015 and 2016, in 2017 there has been only one proxy contest in this sector so far (Daniel Gundersen and Kingsway Financial Services Inc. intended to replace the entire board of Eagle Energy Inc., but none of the dissident nominees were elected). The most active sector remains the materials sector, followed by information technology and real estate.

Despite a partial recovery of oil prices, we see the decline in energy sector activity as a result of the continued depression of oil prices (driven by vague U.S. political policy, rumours of selling down strategic reserves, and ramping up coal) compared to three years ago, when activists likely thought there was more opportunity given the precipitous decline from oil prices in excess of US$100.

Given the volatility of oil prices and no sign of a great recovery to the historic levels of three years ago, combined with the continued deterioration of the balance sheet position of most energy companies, a potential activist's ability to identify viable methods to turn energy sector companies around is significantly impeded. An activist's ultimate goal is still to pursue a strategy that maximizes shareholder value. Activists may not be willing to deploy capital in a sector where companies are significantly levered to continually depressed oil prices and their share price is based predominantly on the commodity cycle – there are few to no pathways to success. That said, we do know of behind-the-scenes activity where activists have explored the possibility of recapitalization, asset sales, and consolidation as part of getting their yield.

Proxy Fights by Sector

SECTOR	2017	2016	2015
Consumer Discretionary	2	2	2
Industrials	1	2	1
Consumer Staples	1	1	0
Health Care	1	1	3
Financials	0	2	3
Information Technology	4	3	4
Telecommunication Services	0	0	2
Utilities	0	0	1
Energy	1	5	15
Materials	9	16	20
Real Estate*	2	0	0
Other	0	1	4
TOTAL	21	33	55

Win Rates by Sector

	2017		2016		2015	
Sector	Management Win	Activist Win/ Partial Win	Management Win	Activist Win/ Partial Win	Management Win	Activist Win/ Partial Win
Consumer Discretionary	100%	0%	100%	0%	50%	50%
Industrials	100%	0%	100%	0%	100%	0%
Consumer Staples	0%	100%	100%	0%	nil	nil
Health Care	100%	0%	100%	0%	33%	67%
Financials	nil	nil	0%	100%	33%	67%
Information Technology	0%	100%	67%	33%	25%	75%
Telecommunication Services	nil	nil	nil	nil	0%	100%
Utilities	nil	nil	nil	nil	0%	100%
Energy	100%	0%	40%	60%	73%	27%
Materials	11%	89%	69%	31%	40%	60%
Real Estate*	50%	50%	-	-	-	-
Other	nil	nil	100%	0%	25%	75%
Overall Success Rates	30%	70%	67%	33%	45%	55%

As of August 31, 2017 *Real Estate is a new sector that was added by S&P Dow Jones indices in 2016.

This year, we saw the reversal of success rates, with activists scoring a series of wins or partial wins. While the sample size has shrunk this year, in 70% of the fights in 2017, activists won some or all of their objectives, whereas the activist success rates in 2016 and 2015 were 33% and 55%, respectively. Activist success was seen especially in the materials sector, where activists won in whole or in part in 89% of the cases in 2017, compared to 31% and 60% in 2016 and 2015, respectively.

We see three reasons for the uptick in activist wins. First is the increased scrutiny and the target screening activists apply at the front end – meaning they are weeding out those companies who are best prepared and targeting some of the weakest management teams. Second, as shown in the cases of PointNorth Capital vs. Liquor Stores N.A., and FrontFour Capital Group and Sandpiper Group vs. Granite REIT, properly structured activist campaigns are gaining increased traction with the proxy advisors and generating supportive vote recommendations. Third, while activists may have an ideal scenario they want to see implemented, if the stock is up and they're making money, they may be willing to conclude that partial improvements will do.

Key Themes of the 2017 Proxy Season

Transactional proxy contests, something we explore in greater detail on page 35, continue to trend upwards. In 2017, they represented 33% of all proxy fights, whereas board-related contests represented 67% *(Figure A)*. Among board-related proxy contests, we see the continued reversal of what had been a growing trend in the popularity of minority slates *(Figure B)*. While the surge in popularity of majority slates is skewed by the smaller sample of proxy contests in 2017, this is the first year where activist success rates have increased for both short and majority slates *(Figure C)*.

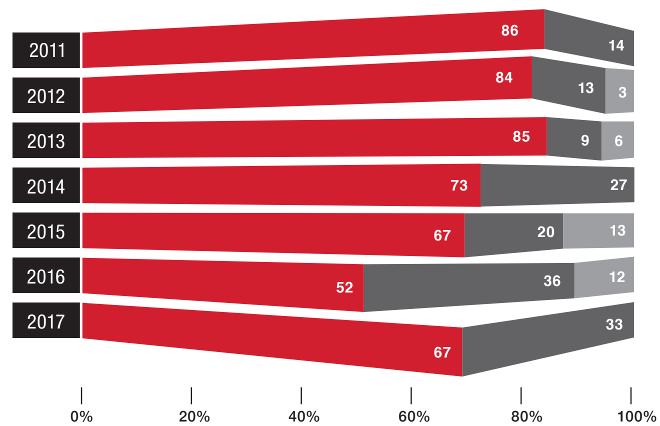
While it appears the principle of proportional representation, especially vis-à-vis ISS and Glass Lewis, may make it easier for minority slates to win, activists will weigh the minority slate strategy against the number of directors they believe they need on a board to create change. Irrespective of the slate type, 2017 has been a good year for activists.

Activist Objectives

(As a Percentage of Total Proxy Fights)

- Board-Related
- Transactional
- Other

Figure A



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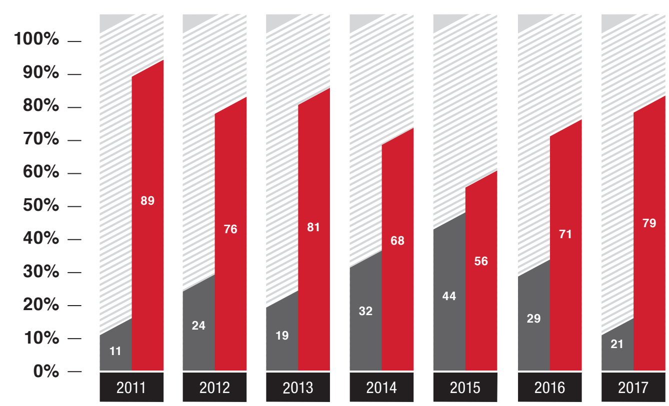
Activist Slate Types

(As a Percentage of Total Board-Related Proxy Fights)

- Majority
- Minority

Figure B



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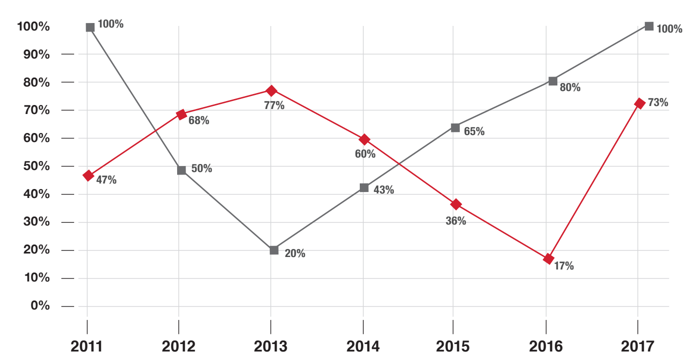
Relationship Between Slate Type and Activist Win

(As a Percentage of Instances Where Each Slate Type Was Used)

- Majority
- Minority

Figure C



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PROXY CONTEST HIGHLIGHTS AND SHOWCASE

Activism in Transactions

We saw three transactions contested this year, including two take-private transactions by traditional private equity firms that saw a bump-up in the offer price.

Rayonier Advanced Materials' acquisition of Tembec Inc. for $4.05 per share was opposed by Oaktree Capital Management LP, which held close to 20% of the shares and rallied the support of over 50% of shareholders. Both ISS and Glass Lewis changed their voting recommendations from "For" to "Against" after Oaktree criticized the deal as undervalued. Ultimately, Rayonier Advanced Materials decided to sweeten their offer to $4.75 per share, which then earned the support of shareholders.

In the first take-private at Sandvine Corp., a competing offer was made by Francisco Partners during the go-shop period after Vector Capital's initial friendly offer. From an initial $3.80-per-share offer, Francisco Partners first put in a competing offer of $4.15 per share, which was matched by Vector Capital, followed by a further bump to $4.40 per share, which was not.

For Milestone Apartments REIT, an original take-private offer of US$16.15 cash per unit was recommended against by ISS after speaking to opposing unitholders, AGF Management Ltd., and Manulife Asset Management Ltd., who were publicly vocal about their opposition. Ultimately, Starwood raised their offer slightly to US$16.25 per unit, which convinced several institutional unitholders to vote in favour of the revised transaction. Despite the sweetened offer, ISS still retained its "Against" recommendation, though it encouraged clients to contact their account managers to ensure any vote changes would be processed ahead of the looming vote cutoff.

It is worth noting that in all of these cases, opposition came from credible institutional investors.

Universal Proxy in Use

A universal proxy, also known as a 'universal ballot', is a proxy card that provides the ability for management and/or the activist to place both management and activist nominees on their respective cards. This type of proxy card has been endorsed by the Canadian Coalition for Good Governance and is deemed the best way to enable shareholder democracy as it allows shareholders to elect what they consider to be the best available board rather than just one of two competing slates. In the past, Pershing Square Capital successfully used the universal proxy against Canadian Pacific Railway (management also used a universal proxy).

In general, universal proxies, if used strategically in a proxy fight, may create an increased chance of proxy advisors recommending to vote on the universal ballot. Depending on whether the opposing side also uses a universal proxy, this can provide a greater degree of visibility, given that shareholders are more likely to vote on a universal ballot.

The use of a universal proxy could also affect split votes, with shareholders able to pick and choose some but not all of an activist's nominees, negatively impacting the chance of complete success. As such, careful consideration should be given to the number of seats sought, the ability of management to manipulate the board size, the activist's objectives, filing sequences, and other specifics unique to the campaign.

In FrontFour Capital Group and Sandpiper Group's proxy contest to name three directors to Granite REIT's board, FrontFour and Sandpiper used a universal proxy card while management chose to use a traditional one. When seeking minority representation, having a universal proxy card is the only way to enable voters to use your card while preserving their ability to vote for incumbents. While another strategy could have been to use a 'blended' card where the activist selects the incumbent directors voters should re-elect, the decision by FrontFour and Sandpiper to use a universal proxy left that choice to voters. A risk with the universal card is that vote dispersion may lead to an incumbent being elected at the expense of one of the activist's nominees (given that you add the votes on the dissident card to those received on the management card). In this instance, by publicly targeting the management nominees that should not be re-elected, the activist maintained the optics of a full democratic process while achieving the desired outcome.

In another situation, several smaller activist shareholders were successful in convincing Karnalyte Resources to provide access to the proxy by placing dissident nominee profiles in the management information circular as well as management's universal ballot. The result? Four of six activist nominees were elected.

CONCENTRATION ON COMPENSATION

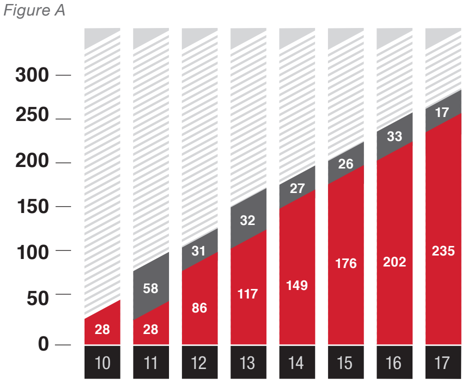
In tracking the seventh year of say-on-pay, we see an understandable decline in the level of new adopters. This year, there were only 17 new adopters, compared to 33 in 2016, for a total of 252 companies *(Figure A)*. We see this as a natural decline, as the number of companies with an inclination to opt in to say-on-pay is limited. That said, we continue to advise companies to consider adopting say-on-pay both as a best-in-class practice and as an added protection for compensation committee members who might otherwise be withheld on by proxy advisors and by displeased shareholders in the absence of a vote on pay.

Average support has generally been trending down since 2010, when management say-on-pay started, with 90.66% average support in 2017 versus 90.96% support in 2016 *(Figure B)*. We believe the decline in support is a function of the developing policies of institutional shareholders and their willingness to take a stronger stance against say-on-pay as well as the increased scrutiny proxy advisor ISS has placed on say-on-pay votes.

Say-on-Pay Support Adoption in Canada

Adopted In Respective Year
Adopted Previously

Figure A



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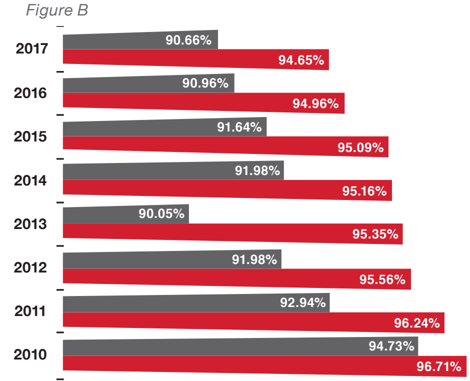
Say-on-Pay Support Level

Average
Median

Figure B



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Increased Scrutiny by Proxy Advisors

This year, we tracked a record 18 ISS and 12 Glass Lewis against recommendations (not including withhold recommendations against compensation committee members whose companies did not have a say-on-pay vote). Among companies receiving against recommendations from ISS, the average support level ended up at just 64.83%. Historically, Glass Lewis had been more aggressive than ISS in recommending against say-on-pay. 2016 was the first time ISS became more aggressive, and the trend continued in this record-setting year. Interestingly, only four companies out of the 18 that received an against recommendation from ISS failed their votes.

The heightened level of scrutiny is evident in the case of BlackBerry. ISS' initial review indicated a "low" degree of concern, which was subsequently upgraded to a "high" degree of concern after a qualitative review. A concern level jump from "low" to "high" is demonstrative of the increasing importance of ISS' qualitative review process that may override any quantitative analysis. This type of concern-level upgrade from ISS is most often seen for egregious one-time events, although we do believe continuing compensation concerns that are less egregious but occur year over year may lead to such quantitative level upgrades as well. This also shows that the two prongs of ISS' approach – quantitative pay for performance tests and qualitative review of all aspects of the compensation program – are both important.

Having said this, a negative ISS recommendation is not the end of the line. Shareholder composition is, of course, an important determining factor, and ISS' influence will depend on the number of its subscribers within an issuer's shareholder base and their adherence to ISS' recommendation. Companies with significant or strategic shareholders that are supportive may find it easier to bypass a negative ISS recommendation. However, shareholder engagement remains one of the best defenses against a say-on-pay controversy, regardless of shareholder composition. Recall that 2017 is the first year Glass Lewis institutionalized its "board responsiveness" policy to a failed say-on-pay vote in addition to a sub-75% say-on-pay vote. Now, Glass Lewis' guidelines clearly state, "the new guidelines for Canada clarify that we may recommend voting against members of the compensation committee if the committee fails to address shareholder concerns following a company's failure to secure majority approval of a say-on-pay proposal."

Companies Failing in 2017

A total of four Canadian incorporated companies failed say-on-pay this year for the first time. ISS had recommended against say-on-pay at all failing companies while Glass Lewis recommended against say-on-pay at all companies except Eldorado Gold Corp.

TransAlta Corporation	Primero Mining Corp.	IMAX Corporation	Eldorado Gold Corp.
27.29%	29.50%	29.98%	43.13%

Key Themes for the 2017 Proxy Season

In reviewing countless information circulars and supporting our clients as they prepare for their say-on-pay votes, we have noticed several key themes and challenges to keep in mind for the 2017 proxy season.

Performance goal rigour scrutinized: This year, we see increasing scrutiny over the rigour of performance goals within pay programs and we expect this trend to continue. Whereas previously shareholders would look at whether these metrics were disclosed (e.g. target, threshold, and maximum goals), now they look at whether the targets themselves make sense.

Absent other information, a common evaluation on the quality and rigour of goals is the comparison of look-forward target goals against historic target goals, as well as the actual achievement and market guidance. When future targets are set below past levels or results, proxy advisors and shareholders often raise concerns. But there may be legitimate reasons as to why targets do not necessarily trend upwards indefinitely year over year, and this does not always indicate a failure to implement stretch goals. Planned capital events can be a major swing factor. Where these can be controlled by management, any positive variance narrative must be watertight. Take free cash flow for example. Free cash flow targets may increase or decrease depending on the business cycle and corporate strategy. Companies know best the story behind shifting targets, so the onus is on them to elaborate on these nuances in their CD&A disclosure and ensure shareholders understand.

HR must talk with IR: Performance goal targets may be assessed via corroboration from other public sources like statements made in earnings calls, corporate presentations, and audited financial statements. Shareholders will increasingly draw parallels between what management is saying and how management is measured and paid because governance teams at institutional investors often interact with portfolio managers. Enhanced communication between HR and IR teams is prudent because any publicly disclosed metric and corresponding targets may be picked up by shareholders and proxy advisors. For example, a bullish statement made on an earnings call for a return-based metric without the corresponding stretch targets in the short-term incentive plan (assuming the metric is part of the plan) may raise questions regarding the plan's rigour. In one case last year, a CEO's performance target was set not only below actual current achievement but also well below market guidance given. Shareholders picked up on the fact that it looked like a 'guaranteed' award. Yet another reason why it is important for companies to tell their own pay-for-performance story in the CD&A.

Shifting of performance cycle for long-term incentives: We see an increased need for companies to shift long-term incentive granting cycles to after year end for the performance year prior. Granting long-term incentive awards, primarily based on 'benchmarking' in the year performance is measured, is problematic on two fronts. First, in-the-year grants restrict the board's ability to adequately consider year-end performance before determining the size of grants. When shareholders assess pay-for-performance, they look at year-end performance. Hence, it makes sense for the board to have the same information shareholders have before deciding on the size of long-term incentive grants.

Secondly, given that equity awards usually represent the largest component of total direct compensation, boards that practise in-the-year grants running into pay-for-performance problems can only resort to short-term bonus reductions or, in more extreme situations, forfeiture of previously granted equity. Neither of these options is palatable, as equity award forfeiture is cumbersome and bonus reduction or elimination may not be enough to alleviate shareholder concerns. For companies that choose to forfeit short- or long-term incentive awards after shareholder backlash, we see this as a less effective reactionary approach, as shareholders assess a board's intention at the time of the grant more closely than the actual grant itself. Therefore, to afford the board more runway in preparing for say-on-pay, an after-the-year grant of long-term incentives, preferably based on well-defined performance metrics, represents the best approach to mitigating surprise pay-for-performance concerns.

Fundamentally, whatever the components of executive pay, if there is excessive pay relative to performance and shareholder value experience, expect a problem.

Companies That Failed Last Year – Where Are They Now?

Last year, Canadian Pacific Railway and Crescent Point Energy failed say-on-pay, with 49.9% and 31% support, respectively. Both companies received negative recommendations from both ISS and Glass Lewis.

In response to failing say-on-pay, Canadian Pacific Railway engaged both ISS and Glass Lewis and held in-person meetings with 16 of its largest shareholders representing approximately 30% of its public float. Canadian Pacific Railway also disclosed substantive changes to their short-term and long-term incentive plans and addressed many of the proxy advisors' concerns from the previous year. Although ISS recommended that shareholders vote against the say-on-pay motion again in 2017, Glass Lewis was supportive and, as a result of the engagement efforts, Canadian Pacific Railway's say-on-pay garnered 71.11% support.

Crescent Point Energy disclosed that approximately 30% of its shareholders were invited to engage, with approximately 15% electing to share their views directly with Crescent Point Energy's compensation committee chair. Up to the date of the information circular, the compensation committee chair engaged approximately 30% of the shares outstanding as well as both ISS and Glass Lewis. Crescent Point Energy also made changes simplifying its compensation plans, transitioning to a more traditional Performance Share Unit Plan and, most notably, seeing CEO compensation decline approximately 50% year over year. Both ISS and Glass Lewis supported Crescent Point Energy's 2017 say-on-pay vote and, ultimately, the company received 86.4% support.

Sector Adoption Trends

Given their large representation within the Canadian marketplace, it is no surprise that for the past three years materials sector issuers represented the largest number of new adopters. Among new adopters, the level of support generally trends above 85% *(Figure A)*, with the exception of one new adopter in 2017 (Sierra Wireless, Inc.) receiving 77% support despite support from both ISS and Glass Lewis (Sierra Wireless, Inc.'s second largest shareholder, BNY Mellon Wealth Management, had voted against the company's say-on-pay). Anecdotally, this high level of support is not surprising, as new adopting issuers are often confident in their say-on-pay and generally phase into adoption by ensuring their previously established compensation plans align with shareholder expectations over a couple of years.

Figure A

New Say-on-Pay Adopters by Industry

	2017		2016		2015	
Sector	**Number Adopted**	**Average Support**	**Number Adopted**	**Average Support**	**Number Adopted**	**Average Support**
Energy	2	98.09%	11	90.97%	5	94.01%
Materials	8	91.62%	12	93.79%	10	89.88%
Industrials	1	85.86%	3	91.53%	4	93.72%
Con. Discretionary	1	97.03%	4	93.94%	2	97.35%
Con. Staples	0	-	0	-	1	91.16%
Health Care	0	-	1	99.95%	0	-
Financials	0	-	0	-	2	95.32%
IT	1	77.20%	1	95.13%	0	-
Telecoms	0	-	0	-	0	-
Utilities	2	98.53%	1	98.31%	2	97.39%
Real Estate	2	93.33%	0	-	-	-
Total New Adopters	17	92.52%	33	93.14%	26	92.85%
Total Average	90.65%		90.96%		91.64%	

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As with previous years, the energy and materials sectors continue to have a significant number of new adopters *(Figure B, next page)*. Average support within the health care sector represents the lowest across all sectors, though this is predominantly skewed by a relatively small sample of votes and with two low results companies (Aralez Pharmaceuticals: 59.72%; and Valeant Pharmaceuticals: 67.88%).

The telecoms sector has the highest level of average support, dominated by BCE Inc., TELUS Corp., Cogeco Inc., and Cogeco Communications Inc., all with support in excess of 90%. Rogers Communications Inc. remains the only large telecom in Canada without a say-on-pay vote, but given their family-controlled shareholder base, they may be able to slip through without holding the advisory vote.

Figure B

Sector Support

2017

SECTOR	GICS	Average Support
Energy	10	93.55%
Materials	15	87.78%
Industrials	20	89.82%
Con. Discretionary	25	90.46%
Con. Staples	30	96.39%
Health Care	35	84.40%
Financials	40	92.95%
IT	45	86.86%
Telecoms	50	96.42%
Utilities	55	90.43%

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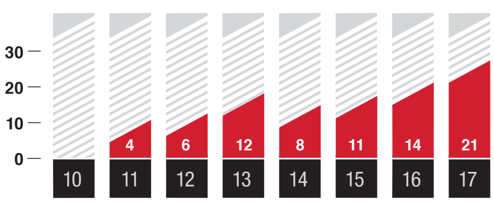
More Companies with Less Than 75% Support

Tracking the number of companies with sub-75% support levels, we see a general increase since 2010. In fact, 2017 has the highest number of companies failing to reach the 75% threshold.

We see this as a general trend of shareholders becoming more active on pay issues. Of course, the increased number of ISS recommendations also play into this. Given that Glass Lewis' board responsiveness threshold is 75% (ISS' threshold is 70% for say-on-pay), boards must be more diligent than ever in combating potential compensation controversies before they surface and before a seemingly benign advisory vote leads to withhold recommendations on directors.

Companies with Say-On-Pay Votes Receiving Less Than 75% Support (By Year)



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Be Aware of Losing Your Foreign Private Issuer Status

Companies listed on both the Canadian and U.S. exchanges that are subject to foreign private issuer status by the SEC should regularly assess their shareholder base to ensure that they are aware of their current status and prepared to be assessed under ISS' U.S. policies.

In addition to increased costs of regulatory scrutiny should such status be lost, issuers should also be aware of the unintended implications for their shareholder meetings based on different ISS and Glass Lewis assessments. In the case of ISS, once an issuer loses its foreign private issuer status and becomes a U.S. domestic issuer, ISS will evaluate the company under its U.S.-based guidelines.

In terms of executive compensation, this means big changes. For one, the company will now be evaluated under a more stringent set of pay-for-performance thresholds and against U.S.-listed companies only as opposed to Canadian-listed peers. Especially against a declining Canadian dollar/U.S. dollar environment, this could mean underperformance just given the exchange differences. On balance, U.S. companies tend to pay higher than Canadian companies, so this may also have the reverse effect.

However, in our experience, ISS analysis via the U.S. framework may yield tougher qualitative scrutiny. To ensure you aren't caught flat-footed in such an event, ensure that engagement with shareholders is kept up to date, maintaining a direct link with governance decision makers at these organizations.

KEY GOVERNANCE DEVELOPMENTS

Emergence of Virtual AGMs

Virtual meetings have been prevalent and growing in the U.S. since 2009; however, they have been almost non-existent in Canada. This is predominantly due to the lack of Broadridge Financial Solutions, Inc.'s integrated virtual meeting service, which has forced Canadian issuers to coordinate with other third parties and their transfer agents in order to execute a truly virtual meeting. According to Broadridge, the largest provider of virtual meeting services, at least 250 U.S. companies will host virtual meetings (both virtual-only and hybrid as discussed below) in 2017, up from 187 in 2016. Only two Canadian issuers, Goldcorp Inc. and Concordia International Corp., held a virtual meeting during the 2017 proxy season.

In contrast to conventional physical shareholder meetings, virtual meetings allow individuals to participate from the comfort of their homes. Although issuers often provide an online webcast of their shareholder meeting, it is only truly virtual if it preserves the features of a traditional meeting by giving registered shareholders and proxy holders the ability to vote at the meeting. Virtual meetings can be categorized as "hybrid" – meaning the issuer has a parallel physical meeting and virtual component – or "virtual-only" – meaning the only way to participate is online.

If Broadridge introduces their virtual meeting services in Canada for 2018 proxy season as planned and transfer agents continue to develop virtual meeting platforms and expertise, virtual meeting adoption in Canada is expected to increase significantly.

Virtual meetings have not come to the forefront of the governance discussion in Canada and most major institutions have yet to take a public stance on the subject. ISS announced that it is currently soliciting feedback on the use of virtual meetings as part of its 2018 policy survey and, recently, several pension funds have indicated a preference for hybrid over virtual-only meetings.

Similar to experiences in the U.S., there may be resistance to Canadian issuers adopting virtual-only meetings. In one notable example, New York City's Comptroller has taken a negative view of virtual-only meetings, claiming that they stifle corporate accountability and limit transparency. According to its recently published proxy voting policies, the New York City Pension Funds may withhold votes from directors on the governance committee if issuers host a virtual-only meeting.

CONSIDERING A VIRTUAL AGM?

This year, Kingsdale helped usher in new approaches to AGMs in the digital age, helping Goldcorp Inc. with their hybrid meeting and Concordia International Corp. in their adoption of the first virtual-only meeting in Canada. Here are some key insights to consider:

- Traditional AGMs generally consist of two distinct segments: the legal meeting and related voting on the business of the meeting, which is generally followed by a management presentation. The typical management presentation includes comments on the fiscal year just ended, updates on the first quarter of the current fiscal year, and other discussion of the plans and priorities for the year ahead. Accordingly, the first consideration is whether to hold both segments or only the legal meeting. Both adopters of a virtual meeting component during 2017 so far have elected to only host the legal business of the meeting and have dispensed with the management update. In many Canadian AGMs, the company's Q1 results are announced the day before or the day of the AGM along with investor conference calls, leading to some duplication of information
- Companies need to be clear on who exactly their annual meeting is for. Over time, many Canadian issuers have seen declining shareholder turnout (down to a mere handful even for large cap companies) and ever increasing third-party turnout. Members of the community, press, analysts, vendors, and social activists now outnumber shareholders significantly. While most companies have no problem with having a webcast of the meeting and/or management update for the various interested third parties, some are now questioning the cost and potential disruption of such "guests" and reconsidering their registration and logistics for the meeting
- Given that 99% of the vote will continue to be done by proxy prior to the meeting, we believe that real-time virtual voting at the meeting by registered shareholders will have minimal impact on the vote outcome
- Hybrid meetings are and will be viewed favourably by shareholders because they broaden shareholder access while maintaining all of the features of a conventional in-person shareholder meeting
- Issuers will need to be cognizant of possible backlash associated with adopting a virtual-only meeting, especially as views on the topic continue to evolve. Shareholder proposals to eliminate virtual meetings and negative press associated with adoption are some of the risks issuers will face. To mitigate such risks, issuers should consider adopting and disclosing procedures related to their virtual-only shareholder meeting (including any Q&A component) in order to improve process transparency
- Adopting a hybrid meeting affords issuers the opportunity to test the waters prior to transitioning to a virtual-only meeting

Majority Voting Triggered

This year, among non-contested situations for TSX-listed companies, we identified one case where majority voting policy was triggered. Over the same period last year there were two public cases where the majority voting policy was triggered.

One director at Endeavour Silver Corp. failed with 47.8% support. Immediately after the shareholder meeting date, the company disclosed that the director in question tendered his resignation pursuant to their majority voting policy and the corporate governance and nominating committee would consider the resignation. Approximately one week later, the company indicated that the committee determined that this was due to a recommendation made by a proxy advisory firm who considered the director to be "overboarded" by virtue of sitting on the board of six different public companies, and that the director had resigned from the board of one of these companies and would no longer be considered overboarded. As such, the resignation was not accepted.

In another case at Acasta Enterprises Inc., one director withdrew his nomination prior to the meeting date. We note that ISS had recommended shareholders withhold votes from said director (Glass Lewis recommending for) and expect the withdrawal was likely an attempt to avoid the expectation of falling below the majority voting threshold.

New Guidance for Advance Notice

On March 9, 2017, additional guidance by the TSX was released regarding majority voting and advance notice policies for TSX-listed companies. Focusing on the amendments to advance notice, the most important highlight was that the TSX believes the current proxy advisor guidelines for the notification periods for advance notice are acceptable. In the most basic version, this refers to an ISS-compliant notice period that is no less than 30 days prior to the meeting date, or 40 days taking account of notice-and-access.

However, the TSX had noted several provisions that they find to be inconsistent with advance notice policy objectives. Notably, they highlighted the following four provisions as problematic:

- Requiring the nominating security holder to be present at the shareholder meeting
- Requiring the nominating security holder to provide unduly burdensome or unnecessary disclosure
- Requiring the nominee or nominating security holder to complete a Personal Information Form (PIF)
- Requiring the nominating security holder to complete a questionnaire, make representations, submit an agreement, or provide a written consent in the form specified by the issuer

While the current version of the ISS benchmark guidelines do not expressly forbid the aforementioned provisions, we have seen ISS recommend against advance notice by-law amendments or policies based on the inclusion of the above provisions. This means that after the TSX release, ISS has amended their internal guidelines to reflect the TSX's new policy position.

We anticipate that next year, ISS will formally update its advance notice provision guidelines to reflect these changes. We do remind issuers that without amendments to their by-laws, companies need not change their advance notice provisions. However, any company contemplating by-law changes should be wary of these developments.

Proxy Access

The first foray into proxy access in Canadian history occurred when nearly identical proxy access shareholder proposals were submitted by Lowell Weir at the Toronto-Dominion Bank and the Royal Bank of Canada. The TD vote passed by a slim margin with 52.2% support and RBC's failed with 46.8% support.

We observe that the proposed structure in both cases, colloquially known as the 3/3/25 version (shareholders holding 3% for three years may nominate 25% board representation to be included in management proxy), is in line with U.S. practices but at odds with the version endorsed by the Canadian Coalition for Good Governance. Specifically, the CCGG version has no holding period requirement. The structure of the proxy access proposals received by the two banks is noticeably more onerous on the nominating party than the CCGG-endorsed version without the holding period requirement. A possible reason for going further than the CCGG proposal is to make proxy access more palatable for the companies targeted. We see these two examples as a tactical approach by shareholder proponents to test the waters in hopes of starting the proxy access discussion in Canada.

In terms of proxy advisor recommendations, ISS supported both proposals, whereas Glass Lewis recommended against both. In their determinations, ISS had conceded that while the current Canadian landscape has proxy access rights in principle, they are seldom used and, as such, support for the proposal is warranted. Glass Lewis, in coming to their recommendation of voting against the proposals, stated that they were concerned about the legality and feasibility of companies regulated under the Bank Act adopting proxy access provisions. As such, it remains to be seen whether Glass Lewis' recommendation will change at other non-bank entities.

Key ISS Arguments

- While proxy access rights exist in law, they are seldom used
- Board control over the process of shareholder proposal nominations (extent and placement of information) do not provide an even playing field for shareholders to nominate directors
- The shareholder proposal is non-binding, majority support would not automatically yield proxy access rights, and proxy access does not automatically entitle a shareholder nominee to a board seat; majority shareholder support will still be required for election

Key Glass Lewis Arguments

- Concerned with the feasibility and legality of companies regulated under the Bank Act in adopting the requested proxy access provisions
- Recognizes current provisions already in place allowing a shareholder owning 5% of the bank's shares for six months to nominate a director candidate
- Believes the adoption of proxy access at this time would not serve the best interests of shareholders

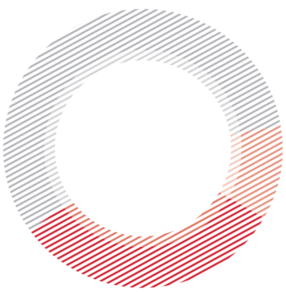
Having passed at TD, we expect that other issuers will receive similar proxy access proposals in the future. It is believed that most, if not all, pension funds in Canada will support proxy access shareholder proposals and that ISS will continue to support such proposals as they did with TD and RBC.

THE RISE OF DIRECTOR–SHAREHOLDER ENGAGEMENT

A SAMPLING OF SHAREHOLDER EXPRESSIONS

Surveying the top 30 companies within the S&P/TSX 60 Index, we find that 19 have discussed shareholder engagement in their management information circulars with differing levels of disclosure:

ENGAGEMENT RESPONSIBILITY



58% – Disclose that engagement is conducted by board or specific committees/members

31% – Do not differentiate between board or management engagement

11% – Disclose that only management engages with shareholders

21% – Clearly disclose the level of shareholders engaged

16% – Clearly disclose that they met with proxy advisors

Director–shareholder engagement is quickly becoming the norm – not only because more investors are becoming increasingly clear they want access to independent directors, but because directors themselves are coming to understand the value of getting out from behind boardroom doors: the ability to socialize shareholders to important decisions, showcase board expertise, create self-awareness and understanding of expectations, and build trust and personal capital.

While some companies may be informally engaging shareholders on an ad hoc basis and not reporting on it, it is important to understand that a growing number of shareholders want to see formal policies and proof of engagement.

Shareholder Engagement Trends

Several companies have adopted a formal shareholder engagement policy as a form of best corporate governance practice. Barrick Gold formally introduced a shareholder engagement policy in 2016 which was disclosed in its entirety on the company's website. The policy specifically states, among other things, that Barrick's lead director will meet with institutional shareholders throughout the year to discuss governance matters and the chair of their compensation committee will meet with institutional shareholders to discuss executive compensation. It also outlines specific ways to communicate with directors as well as with Barrick's management. Similarly, Manulife Financial Corporation has adopted "Shareholder Engagement Principles" whereby "the board has developed a program, led by the Chairman and supported by Manulife's investor relations team, to facilitate engagement with shareholders. Accordingly, the Chairman, at his or her discretion and in accordance with Manulife's disclosure policy, meets with Manulife's shareholders and organizations representing groups of shareholders."

Proxy Advisor Initiated Engagement

Broadly speaking, ISS' and Glass Lewis' benchmark guidelines currently describe situations that require board engagement and responsiveness, mainly in reactive circumstances.

One of ISS' fundamental principles when determining vote recommendations on director nominees is board responsiveness. Within ISS' benchmark guidelines, they outline specific cases where board communications and responsiveness are expected.

ISS clearly outlines what it considers appropriate board responses, which may include "disclosure of engagement efforts regarding the issues that contributed to the low level of support, specific actions taken to address the issues that contributed to the low level of support, and more rationale on pay practices," among other things. Beyond say-on-pay, if a management proposal fails or a shareholder proposal passes, ISS will expect the board to be responsive and engage shareholders.

Similarly, Glass Lewis believes that any time 25% or more of shareholders vote contrary to the recommendation of management, the board should demonstrate some level of engagement and responsiveness to address the shareholder concerns. Particular to compensation issues, Glass Lewis believes "the compensation committee should provide some level of response to a significant vote against, including engaging with large shareholders to identify their concerns."

Glass Lewis seeks evidence that the compensation committee is actively engaging shareholders on compensation issues, and they may recommend holding compensation committee members accountable for failing to adequately respond to shareholder opposition.

Typically, issuers can demonstrate responsiveness by engaging shareholders and soliciting their feedback on concern items, enacting and adopting changes and modifications, and then disclosing such changes publicly via their information circular. Engagement efforts should also be described in depth within the circular including who was involved, aggregate level details on shareholders engaged, and changes made as a result.

Shareholder Engagement is the Precursor to Vote Success

In a notable example touched on earlier, in 2016, Crescent Point Energy failed its say-on-pay vote with 31% support due to against recommendations from ISS and Glass Lewis. In preparation for the next annual meeting, Crescent Point engaged with its largest shareholders, representing over 30% of the outstanding shares, to hear their concerns and collect feedback regarding its compensation program. Crescent Point also met with ISS and Glass Lewis to discuss potential changes to its executive compensation program. As a result of these discussions and incorporating feedback received, Crescent Point's 2017 say-on-pay proposal received 86.4% support from shareholders, with ISS and Glass Lewis endorsing.

As the elected representatives of shareholders, it is critical that independent directors not only participate in shareholder engagement but assume a leadership role. While some directors will continue to drag their heels over concerns about the risks of sitting down face-to-face with an investor, we think a bigger risk is not knowing where your shareholders stand.

DEFENSIVE TACTICS – ALIVE AND KICKING

As activism has evolved and boards have become more sensitive to shareholders and recognize the risk of being seen as entrenched, one might think that the use of blatant defensive tactics was a thing of the past – but this proxy season has proven they are still very much alive and kicking.

Private Placements & Litigation – Eco Oro Saga

The Eco Oro saga was riddled with twists and turns, including the use of a share issuance as a defensive tactic along with a vigorous litigation strategy. An activist shareholder with deep pockets and the gambling stamina for the potential reimbursement was a crucial element to this prolonged battle.

Case law continues to support private placements that are conducted in the face of an activist, particularly when there is an actual need for capital, but in the case of Eco Oro, that was not the fact pattern. This was a situation where the incumbents already had 41% support, but, to tip the scale in their favour, they converted debt for equity, resulting in an increase to 46% support.

The facts that placed the incumbents' motives in question were that the debt was at nominal interest rates, it had just been issued a few months prior with ten-plus years left to maturity, and the conversion was coincidentally conducted only eight days prior to the record date for shareholders to vote at the meeting. The nuance here is that the conversion required TSX approval, but there were no cash proceeds to the company – simply a shift on the balance sheet from debt to equity.

While the B.C. courts found in favour of Eco Oro that a case for oppression had not been established and the relief sought was therefore denied, the OSC overturned the TSX's approval of the share issuance, chastising the TSX for approving a private placement that used questionable tactics and was potentially meant to block a proxy challenge, on the basis that the TSX did not properly consider the circumstances around the placement and did not properly apply its own rules. The OSC concluded that the shares could not be voted on at the meeting and shareholder approval would be required for their issuance.

Noting the conflicting rulings and potential appeal, the B.C. court effectively encouraged the parties to resolve their dispute and allowed the company more time to hold their meeting. Shareholders and the company were in limbo from the original meeting date of April 25, 2017 (requisition for the meeting provided February 10, 2017) until the settlement was announced on August 1, 2017. Can one argue this tactic somehow worked? Perhaps due to the required time, various court proceedings, and further costs, a settlement ultimately ensued. What one can't argue is that the battle took two sides with a willingness to go the distance and incur the costs along the way. Hopefully, the settlement reached will ultimately lead to dollars well spent that flow back to shareholders. Let's remember that this is the bigger picture.

Vote Buying – Liquor Stores' Last-Ditch Effort

The other perhaps even more extreme defensive tactic witnessed this season was one we hadn't seen since 2013 in the JANA–Agrium proxy battle. 'Vote buying' in its most fulsome form occurs when management not only pays brokers a fee if their accounts support management but also requires management to win for those fees to ultimately be paid. This is contrary to the traditional argument for paying brokers in the M&A context, where they are remunerated for their time and effort in reaching shareholders vs. the result. This tactic was met with such disdain in 2013 that no one has dared to pull it out in a proxy contest since.

The Liquor Stores board broke the freeze with a last-ditch effort only two weeks prior to their meeting date announcing their intention to pay brokers for votes. Interestingly, Liquor Stores, which had previously conducted no shareholder engagement, claimed the arrangement was needed to ensure all shareholders – retail and institutional – have equal access to important information about the company.

The activist along with other large shareholders here were so appalled by the tactic that PointNorth took it to a hearing at the Alberta Securities Commission as not only an issue in this proxy fight but also an issue of concern to all shareholders and the public going forward. While the ASC did not suspend the payments, they did acknowledge that it should be addressed through dealer compliance oversight and policy development.

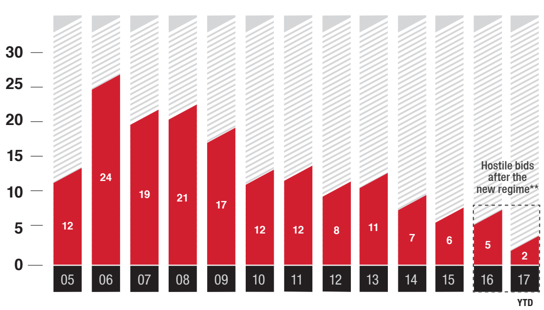
Ultimately, the takeaway from this proxy season is that defensive tactics are here to stay. However, case law continues to help define the parameters of the tactics. Advisors must conduct a careful assessment of the landscape and the potential outcomes of these maneuvers prior to implementation. What is certain is that they can come at a real cost to shareholders. Only value creation over time will prove if worthwhile.

SO MUCH FOR THAT CHILLING EFFECT: THE FIRST YEAR UNDER THE NEW HOSTILE TAKEOVER REGIME

In its first year in effect, the new takeover bid regime has surprised many with its impact. Legal pundits, advisors, and commentators predicted that the new rules would mark the end of hostile takeovers in Canada. They were wrong.

Seven hostile bids were launched since the rules came into effect on May 9, 2016 – the same as in 2014 and one more than in 2015. Not much of a chilling effect, that's for sure.

Number of Hostile Bids* by Year of Initiation



*Includes all hostile bids that targeted Canadian-listed public companies from January 1, 2005, to April 24, 2017.
**All 2016 deals were commenced after the new regime.

DATE BID LAUNCHED	TARGET	HOSTILE BIDDER	INDUSTRY
July 6, 2016	Dolly Varden Silver	Hecla Mining	Commodities
August 3, 2016	Nordex Explosives	Omnia Holdings	Other
October 6, 2016	Canexus Corporation	Chemtrade Logistics Income Fund	Chemicals
October 28, 2016	Franchise Bancorp	WTF Holdings	Financials
December 9, 2016	Savanna Energy Services	Total Energy Services	Energy
January 17, 2017	Apivio Systems	Nuri Telecom	Technology
April 19, 2017	Innova Gaming	Pollard Banknote	Gaming

In looking at the seven completed hostile bids to date, there are some clear lessons. While the new takeover rules have not changed the number or frequency of takeover bids, what has changed are the tactics that make for a successful outcome. Private placements may be the new deterrent in the target's arsenal and locked-up shares may be the new ammunition in the bidder's arsenal. The extended 105-day bid period may, however, in more cases than before lead both to put aside their arsenals and come to friendly terms.

TWO BIDS FAILED:
- Hecla Mining's unsolicited bid for Dolly Varden Silver failed when the bidder withdrew due to a private placement used as a defensive tactic
- Omnia Holding's hostile bid for Nordex Explosives failed because Omnia couldn't outbid the friendly bidder

FOUR BIDS SUCCEEDED AFTER THE TARGET BOARD'S BLESSING:
- Canexus Corporation's board supported an increased offer by Chemtrade Logistics Income Fund
- Apivio Systems' board supported an increased offer by Nuri Telecom
- Franchise Bancorp Inc. supported a bid by WTF Holdings who already controlled over 85% of the target's shares
- Innova Gaming Group Inc.'s board supported a revised higher offer from Pollard Banknote who already had the support of over 40% of Innova shares held by Amaya Inc.

ONE BID SUCCEEDED WITHOUT OBTAINING THE TARGET BOARD'S SUPPORT:
- Total Energy Services' hostile bid for Savanna Energy Services was successful in large part because the bidder had 43% of shares locked up and continued to purchase shares to reach the 50% minimum tender condition

Keys to Success Under the New Hostile Bid Regime

This includes input from Poonam Puri, a seasoned corporate director, practising lawyer, and professor at Osgoode Hall Law School.

Acrimony is out; collaboration may be in: There is no shortage of bids being initiated, but the focus has changed. Gone are the days when a hostile bid routinely triggered the enactment of a poison pill, followed by the bidder running to the securities commissions to challenge the pill and argue over when it should be cease traded. Inevitably, both sides' focus revolved around the pill, and more of the target's time and resources at the beginning were spent on defending the pill to buy more time than on the more critical task of trying to surface better value.

Now are the days (105 in fact) for the target's board to methodically consider the bid and other value-enhancing options in an effort to do what's in the best interests of the company and its shareholders. Given the less directly hostile nature of the relationship between targets and bidders (i.e. not duking it out directly over the length of a pill), now is also the time for potential bidders to strategically approach the target with a win-win value proposition. We know that obtaining the target board's blessing leads to greater success. Both bids that failed (Dolly Varden and Omnia) didn't get the target board's support. However, four out of five that succeeded did so because they ultimately received the board's blessing. Potential acquirers should carefully strategize with their advisors on how to get buy-in from the target's board.

Although not part of the seven examples cited above, the case of Dominion Diamond Corporation being approached by private equity firm, The Washington Companies, is a good example of a possible change in strategy by the acquirers. In this case, The Washington Companies did not launch a formal bid, but rather only threatened to launch one by issuing a public statement expressing its interest in acquiring and a specified offer price. This then led to a strategic process by Dominion Diamond which ultimately resulted in a friendly deal (at a revised higher price) with The Washington Companies. It may be argued that Washington's public approach (without launching a formal hostile bid) was a strategic form of negotiation which ultimately had its desired effect of a friendly deal.

STRATEGIC CONSIDERATIONS UNDER THE NEW RULES

FOR HOSTILE BIDDERS:

01. The longer bid period increases not only the financial risk due to market fluctuations but also the potential to trip up over acting jointly and in concert and selective disclosure.

02. What precedes a hostile bid, such as a strategic review process that does not materialize anything or a failed transaction, may present an opportunity to challenge the 105-day rule on the basis that it is unlikely that any other bidders will emerge on more favourable terms.

03. With a clear timeline of 105 days, the bidder's strategy with regards to launch, press releases, solicitation, etc., should be simpler to map out.

04. It is critical to take into consideration a company's history, the shareholder experience, and future prospects when crafting messaging.

05. On cash deals, the target stock may rally, eroding the implied current premium while the announced premium statement remains very real. On stock deals, the bidder's stock may trade down, eroding the implied premium which translates to real value erosion for target shareholders. 105 days is a long time on some stock graphs.

FOR TARGET BOARDS:

01. While engagement with shareholders is always a good best practice, leveraging competing shareholder views while subject to a hostile bid can surface additional value for shareholders and/or give you support for a go-it-alone stance.

02. Moving from a sprint to a marathon presents a number of practical considerations including internal 'process fatigue' from those working on the defense.

03. When agreement is reached, consider pushing for a reverse termination fee on the bidder to boost the bidder's commitment for a completion of the transaction.

04. Monitor the shareholder base closely throughout the entire duration. Your shareholders cease being your shareholders when the bid launches, often being replaced with a significant complement of arbitrage and event-driven investors.

05. Understand different motives among shareholders – e.g. long-term holders vs. short-term arbs – and be prepared for a proxy contest coming potentially from either the bidder or unhappy shareholders. In a situation where a bidder has only been able to take up just over 50% of the stock but no more, running a proxy contest may be the only way for the bidder to take control of the board and ultimately the target. This was the case in Total Energy Services' bid for Savanna Energy, which was the only hostile bid to succeed without the target board's blessing.

Lock it up: Going into a hostile bid situation with a larger number of shares locked up clearly helps get to the new 50% minimum tender condition. Remember, a soft lock-up (one that is subject to a better offer) will count towards the minimum 50%. At the end of the day, all the bidder needs is the difference between 50% and the locked-up shares to take control of the company.

Cash is king: All of the offers to date were cash except for one. Cash offers reduced uncertainty for the acquirer because they don't have to bear the risk of market fluctuations over the extended 105-day period. An acquirer is well advised to consider the volatility in the sector when structuring the consideration for a proposed bid.

Business Is Booming: Another Big Year for M&A

In the face of continued global uncertainty, Canada remains a safe haven for business and capital. 2017 has so far had the highest level of M&A transactions since 2007. According to Bloomberg data, the first half of the year saw a significant increase in transaction value from the same period in 2016, with over $150 billion in M&A activity. Although a good portion of the increase has been due to foreign oil and gas companies exiting their Canadian investments and in turn being purchased by Canadian companies, the deployment of private equity capital and public company acquisitions remains at an all-time high in 2017.

The foreign oil and gas exits include ConocoPhillips' asset sale to Cenovus Energy for $17.6 billion and Royal Dutch Shell's sale of its oil sands assets to Canadian Natural Resources for $11 billion. The move of oil assets from foreign to domestic hands seems to have been driven by the expense of maintaining the projects and the challenges for non-local entities in operating them. In a tough cycle, companies who are local and know the oil sands better appear best suited to run them.

As provided above, and aside from domestic firms buying Canadian energy assets from exiting foreign companies, 2017 has also been a busy year for private equity investments.

So far in 2017, over $40 billion of private equity has been deployed in Canada, which includes Starwood's $3.8 billion acquisition of Milestone Apartments REIT, Francisco Partners' $420 million acquisition of Sandvine Corporation, and The Washington Companies' proposed US$1.2 billion acquisition of Dominion Diamond Corporation.

During the same period, domestic M&A involving Canadian companies buying Canadian companies or assets has thus far totalled $68.8 billion, according to Bloomberg, which is over double the activity from the same period last year.

Finally, outbound M&A activity, although slightly lower from the same period in 2016, is still above the historical average as Canadian companies seek growth abroad. Largest of these so far has been CIBC's purchase of PrivateBancorp which, after a delay, was approved by shareholders in the first quarter of 2017.

Our outlook for transactions in the remainder of 2017 and first quarter of 2018 remains strong, though this is somewhat mitigated by the headwinds generated by a rising interest rate environment, which may negatively affect acquirers' buying power and/or result in asset sales or equity issuances by overleveraged companies.

ISSUES ON THE HORIZON

section

02.

ESG RISING

Environmental, social, and governance (ESG) issues are quickly moving from a small subset of concern for investors to a core philosophy about how they invest and how they expect the businesses they own to behave.

Investors are becoming increasingly interested in companies' ESG profiles alongside their fundamentals, while companies may find it challenging to understand how their ESG profile will be understood and benchmarked.

This year, ESG shareholder proposals have gained both interest and support in Canada and the U.S., with climate change emerging as the dominant proposal topic. While the governance aspect is nothing new, an emerging laser focus on environmental and social issues has been observed.

What Is Driving the Rise?

There are several factors that are simultaneously driving the rise in ESG investment practices. The first is the acknowledgment that issues such as climate change and human rights are affecting various sectors across the economy, and that the incorporation of ESG considerations can be used as a risk-mitigation screening process when evaluating companies. There is a belief that institutional investors are incorporating ESG factors in their investment processes to identify higher quality companies with strong management teams. Typically, management teams of companies with robust sustainability profiles have a reputation for being able to quickly adapt to changes, better manage risk, and take advantage of opportunities. Similarly, long-term investors may see ESG policies as a foundation for long-term success. Subsequently, such considerations may provide alpha-generating signals to help garner long-term investment performance.

Second, the Paris Agreement and the support from 195 countries has established climate change as a recognized global concern, with reactions to recent statements by the U.S. president only serving to underscore this view. The international treaty has increased investors' acknowledgment of the potential impacts climate change may have on investment portfolios. This recognition has resulted in conversations regarding portfolio de-carbonization and the pressure for issuers to provide greater disclosure regarding climate change–related risks.

The third factor generating greater demand for ESG-related investing comes from the growing number of millennials engaged in wealth management. Millennials represent the largest demographic in North America's workforce, and are estimated to inherit more than US$30 trillion in the next few decades. According to a 2015 survey conducted by the U.S. Trust, Bank of America, approximately 85% of millennials consider social or environmental impacts to be important to investment decisions. This contrasts with baby boomers who were interviewed, with only 49% agreeing that social and environmental impacts are important to investment decisions.

In Canada, millennial investors are significantly more likely than previous generations to show interest in responsible investment. According to 2016 data collected by the Responsible Investment Association of Canada, Canadian millennial investors are 65% more likely than Canadian baby boomer investors to consider ESG factors when making investment decisions. Furthermore, 82% of Canadian millennial investors believe that responsible investing will become more important in the next five years, compared to only 48% of baby boomer investors who share the same belief.

It is worth noting that Europe has historically been at the forefront of responsible practices, with approximately 65% of global responsible investing AUM, rendering it the largest region for responsible assets globally. Still, responsible investing has experienced international growth. For example, at the start of 2016, global responsible investing assets reached US$22.89 trillion, representing a 25% increase from 2014. In nearly every market, responsible investing grew in both absolute and relative terms since 2014.

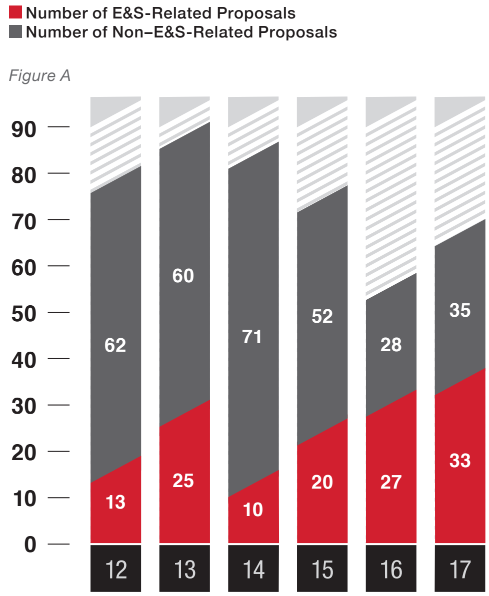
Several investment market players in the U.S., Canada, Australia, New Zealand, and Asia (excluding Japan) have begun ESG integration as part of their investment screening. In the U.S., responsible investing grew by 33% in 2016, representing US$8.72 trillion, compared to 2014. Although smaller than the U.S. responsible investing market, Canadian responsible investing is experiencing rapid growth, with approximately $9.2 billion in AUM in early 2016, representing a 123% increase from 2013 ($4.13 billion).

Canada in Focus

According to the Shareholder Association for Research & Education (SHARE), this proxy season saw an overall increase in the total number of environmental and social (E&S)-related proposals submitted to issuers in Canada, from 27 proposals in 2016 up to 33 proposals in 2017. As illustrated in *Figure A*, there has been an overall increase in the number of E&S proposals submitted to Canadian issuers in the past five years.

In 2016, the only ESG-related proposal submitted at a Canadian company to pass was a climate change reporting proposal at Suncor Energy Inc. (and this was endorsed by management). Conversely, in 2017, Canada has yet to see an ESG-related proposal pass. It is notable that climate change–related proposals represent 33% of all ESG-related proposals voted on by shareholders this year.

Number of Shareholder Proposals Submitted in Canada



As of August 1, 2017

Select Canadian ESG-Related Shareholder Proposals to Date

Issuer	Proposal Received	Management	Voted FOR	ISS Rec.	GL Rec.
Royal Bank of Canada	Approve Disclosure of Lobbying Matters	Against	42.3%	FOR	Against
Canfor Corp.	Adopt Policy on Board Diversity	Against	31.8%	FOR	FOR
Constellation Software Inc.	Adopt Policy on Board Diversity	Against	42.0%	FOR	FOR
Enbridge Inc.	Prepare Report to Identify/Address Social and Environmental Risks when Reviewing Acquisitions	Against	30.3%	FOR	Against
Industrial Alliance Insurance and Financial Services Inc.	Strategy to Counter Climate Change Risk	Against	3.6%	Against	Against
Industrial Alliance Insurance and Financial Services Inc.	Policy to Counter Climate Change Risk	Against	3.5%	Against	Against

As of August 1, 2017

U.S. in Focus

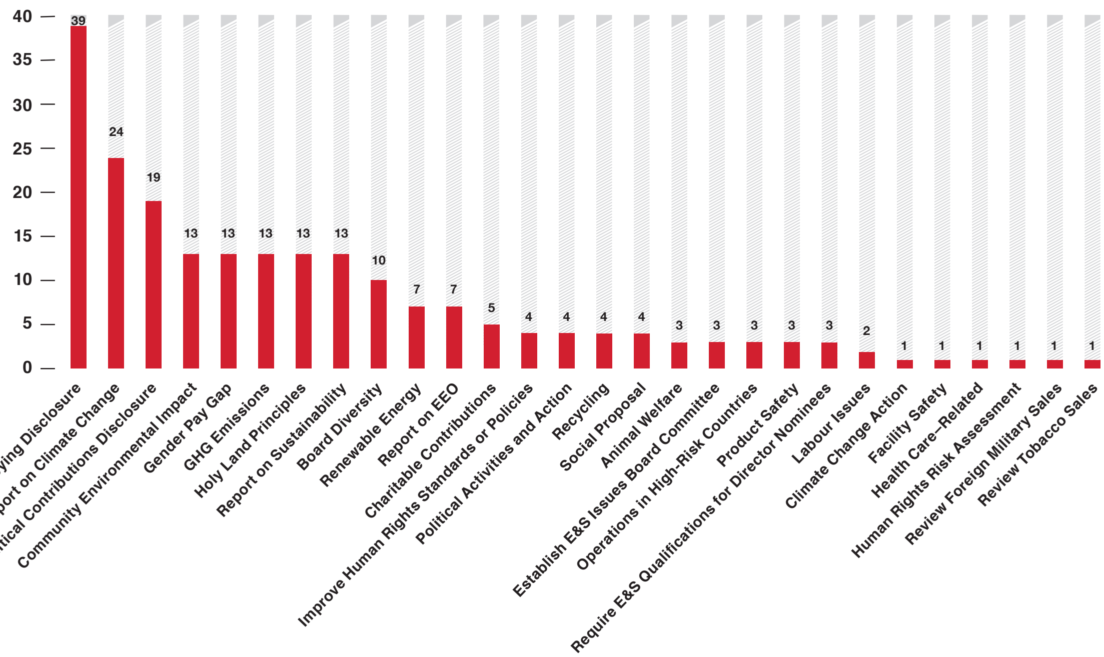
With the U.S. having been on the forefront of ESG, a closer look south of the border shows that a total of 215 ESG-related proposals have been submitted by shareholders in 2017, with 24 being climate change–related proposals. A majority of those climate change–related proposals were generic, requesting that the company provide a report outlining its strategy to prepare for a low-carbon economy and/or assess the long-term impacts that climate change policies may have on a company's portfolio.

Ten proposals were more specific in nature, requesting that a company publish annual reports and disclose the long-term portfolio impacts both technological advances and climate change policies will have on the company, in addition to assessing the resilience of a company's full portfolio of resources, and identifying financial risks associated with different scenarios.

The most popular ESG topics for 2017 are noted in *Figure B* on the next page, with proposals relating to lobbying, climate change, political contributions, and diversity being among the most popular issues.

Figure B

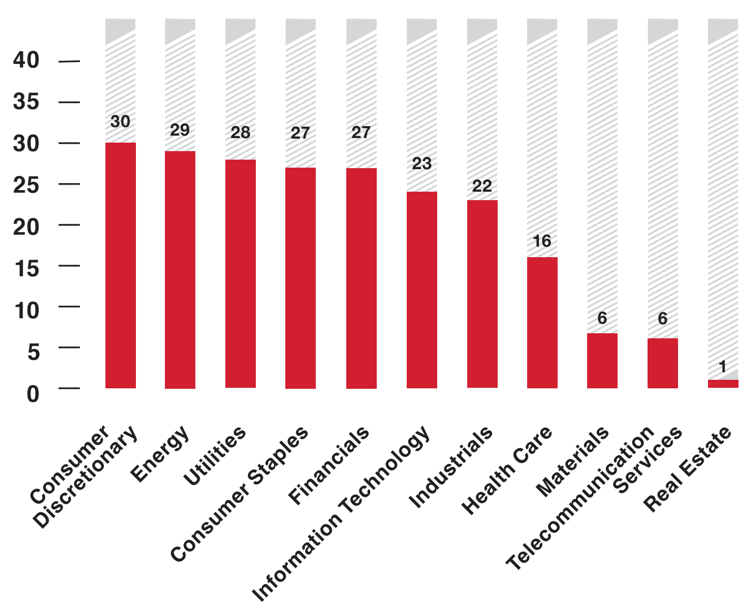
ESG Proposal Topics Submitted in 2017 (U.S.)



As of August 1, 2017. (Includes pending and withdrawn proposals.)

In 2017, the sector to receive the most ESG-related proposals was the consumer discretionary sector (total of 30), closely followed by the energy sector (total of 29), with the following sectors actually having ESG-related proposals pass: energy (3), utilities (1), information technology (1), and real estate (1).

Number of ESG Proposals per Sector (U.S.)



As of August 1, 2017

This proxy season has seen six ESG proposals pass, with the topics concerning climate change (3), diversity (2), and sustainability (1). Most notable are the climate change–related proposals that passed at Exxon Mobil Corp., Occidental Petroleum, and PPL Corp., all receiving majority support (62%, 65%, and 56%, respectively).

The table on the next page provides insight as to how some of the largest institutional investors have voted on environmental and social proposal topics this year in the U.S.

Investor	Environmental and Social Proposals					
	Total Number of E&S Proposals Voted on in 2017 (YTD)	Voted "For"	Voted "Against"	Abstained	Did Not Vote	Percent of E&S Proposals Voted "For" (YTD)
State Street Global Advisors	577	189	311	77	0	33%
BNY Mellon	366	32	334	0	0	9%
BlackRock	216	13	203	0	0	6%
J.P. Morgan Asset Management	181	13	168	0	0	7%
Wellington Management	43	4	36	1	2	9%
Goldman Sachs Management LP	5	4	1	0	0	80%

As of August 1, 2017

More Stringent Investor Views on ESG

Although a small portion of ESG-related proposals gain enough support to pass (both in the U.S. and Canada), it is *how* institutional investors vote that indicates ESG is becoming a growing concern among investors and an increased risk to boards. We have seen more and more large institutional investors changing voting policies to address ESG-related risks.

This year, BlackRock, Vanguard, and Fidelity amended their voting policies to be able to support climate change proposals. Furthermore, institutional investors such as State Street, BlackRock, Vanguard, Norges Bank Investment Management, and CalPERS, to name a few, have identified specific ESG topics they focus on when engaging with investee companies.

There are other international initiatives that underpin the rise of ESG. For instance, on June 29, 2017, the Financial Stability Board's Task Force on Climate-related Financial Disclosures published its recommendations for financial firms to disclose how climate change affects their business. Since its publication, 11 major banks including UBS AG, Citigroup Inc., and Barclays PLC (representing more than $7 trillion AUM) started a pilot project to implement the recommendations. Such initiatives may signal that in the future, responsible investing will move from peripheral to mainstream focus.

How Do ISS and Glass Lewis Approach ESG Proposals?

ISS and Glass Lewis have made it clear through a series of initiatives that ESG will be a big focus going forward, with both proxy advisor firms having recently partnered with ESG research organizations.

In 2015, ISS acquired Sweden-based Ethix to form ISS-Ethix, which helps clients develop and integrate responsible investment practices. ISS also announced a strategic partnership with the ESG intelligence provider RepRisk to offer clients access to RepRisk's ESG platform. The RepRisk platform enables clients to manage reputational, compliance, and investment risks related to ESG issues and serves as a screening tool to monitor portfolio companies' activities for purposes of investment analysis, engagement, or exclusion.

Most recently, ISS acquired Zurich-based South Pole Group, a provider of ESG data and analytics to enable investors, asset owners, fund managers, and banks to measure the impact of climate change on their portfolios. In addition, ISS already has several specialty proxy voting guideline policies that reflect ESG concerns: socially responsible investment (SRI), sustainability, and the faith-based policies.

Similarly, Glass Lewis partnered with Sustainalytics early this year. Sustainalytics is a leading provider of ESG research, ratings, and analysis. Through this partnership, Glass Lewis now integrates Sustainalytics' ESG research and ratings into its proxy research and vote management platform. Glass Lewis subscribers will now have access to Sustainalytics' ESG rating of issuers, as Glass Lewis reports now include Sustainalytics' evaluations within their company reports.

Glass Lewis has stated that Sustainalytics' company ESG rating does not impact its own assessment and/or recommendations regarding issuers. However, it is important for companies to keep an eye on the big picture: as more institutional investors are identifying key ESG topics and concerns, published ESG ratings may become more relevant and impactful in the future.

What Next?

If an issuer is not in the highly targeted extractive industries, that does not mean they are immune. Shareholders will be looking to see who you do business with and try to extend your influence to your vendors.

Given the ESG trends identified above, issuers should prepare themselves for investors' increased demand for enhanced disclosure. One disclosure method is a sustainability or corporate social responsibility (CSR) report, and updating it at least biennially.

Additionally, companies should keep abreast of, and consider participating in, climate change and sustainability reporting frameworks such as the Global Reporting Initiative and the Carbon Disclosure Project. By participating in sustainability reporting frameworks and/or providing quality disclosure regarding sector-specific ESG risks, issuers can be proactive in addressing potential shareholder concerns.

A proactive approach can help reduce the probability of issuers receiving shareholder proposals, as shareholders are more likely to target those companies with reputations for being laggards on ESG initiatives and disclosure.

As time passes, issuers will be increasingly expected to integrate climate change risks and opportunities into their corporate strategy. Issuers should ensure that their board composition has the required expertise to address environmental and social issues, in addition to allocating this responsibility to a specific committee.

Lastly, issuers should inform themselves of large investors' ESG voting policies and engagement topics, and ensure that key issues are addressed in their CSR reports. It would be remiss not to highlight that IROs and boards should focus not only on their current shareholders but also prospective ones. With the increased focus on ESG integration, falling behind in ESG disclosure may mean that prospective shareholders will skip out on investing in your company.

VOTER TURNOUT: WHY TRANSPARENCY MATTERS

An interesting choice in disclosure rules allows some companies to mask low shareholder turnouts. Often, low shareholder turnouts can be indicative of poor governance and poor shareholder engagement.

In Canada, by virtue of how the TSX Company Manual and securities rules are worded, issuers are not required to disclose the voter turnout on the election of directors or other corporate resolutions put to a shareholder vote. Currently, issuers may simply indicate that resolutions were approved by over 95% of votes cast, omitting that only 10% or 20% of shareholders may have actually cast votes.

This is in contrast to the U.S. where issuers are required to disclose shareholder vote turnout, which in turn potentially compels U.S. companies to try to maximize such turnout. This is likely because no company or board would want to disclose a low shareholder turnout for fear of embarrassment or a signal to activists that they might be ripe for the picking.

The same compulsion to maximize turnout does not exist in Canada. Within the TSX we note 35 companies, most of which were under the $1 billion market cap, did not provide disclosure that would allow for the calculation of voter turnout as of August 1, 2017.

How to Fix the Issue?

It appears a simple word change may fix this issue and provide shareholders with greater transparency. Changing the word "*or*" in NI 51-102 section 11.3 and TSX Company Manual Section 461.4 to an "and" would make a significant difference:

NI 51-102 Section 11.3 Voting Results

A reporting issuer that is not a venture issuer must, promptly following a meeting of securityholders at which a matter was submitted to a vote, file a report that discloses, for each matter voted upon (a) a brief description of the matter voted upon and the outcome of the vote; and (b) if the vote was conducted by ballot, including a vote on a matter in which votes are cast both in person and by proxy, the number *or* percentage of votes cast for, against or withheld from the vote.

TSX Company Manual Section 461.4, Footnote 1

The news release is intended to provide the reader with insight into the level of support received for each director. Accordingly, issuers should disclose one of the following in their news release: (i) the percentages of votes received 'for' and 'withheld' for each director; (ii) the total votes cast by ballot with the number that each director received 'for'; *or* (iii) the percentages and total number of votes received' for' each director.

In contrast, in the U.S. the Securities Exchange Act clearly indicates issuers must "state the number of votes cast for, against or withheld, as well as the number of abstentions and broker non-votes as to each such matter."

Why It Matters

High levels of shareholder participation are a sign of good governance and provide confidence that the company's directors and their strategic direction are not just being rubber-stamped by a few insider shareholders. High shareholder participation shows that the board has a broad mandate from shareholders as opposed to a select few who vote. The lack of a total shareholder turnout disclosure requirement allows some boards to escape scrutiny regarding the breadth of their mandate and support from company shareholders.

According to the latest statistics available from an OECD report outlining average shareholder participation in different jurisdictions, Canada places in the 61–62% participation range

This is a much lower figure than in the United States (at 82%) and lower than the UK, Germany, and Japan. What is most interesting is that in Canada's case the statistics only include companies that actually disclosed their participation rate. One can assume that those that did not disclose may well have had a lower participation rate, which means that the average participation rate may actually be much lower than the 61–62% reported.

Clear communication of voter participation is a fundamental right of shareholders and good for the market. Requiring Canadian issuers to disclose the participation level at a shareholder meeting will put pressure on issuers with historically low participation levels to strive to increase those levels.

THE TABLE BELOW SHOWS THE STATISTICS OF AVERAGE MEETING TURNOUT PER COUNTRY, EXPRESSED IN TERMS OF PERCENTAGE.

	Country	AGM Overall
Slovakia	98.45%	98.45%
South Korea	78.52%	81.97%
United States	81.78%	81.78%
Brazil	No data	76.58%
Estonia	78.48%	76.38%
Czech Rep.	77.91%	76.00%
Japan	74.73%	74.73%
Slovenia	73.35%	73.35%
Spain	70.06%	71.30%
Turkey	68.81%	67.79%
UK	67.62%	67.50%
France	66.84%	67.16%
Luxembourg	74.36%	66.16%
Germany	64.86%	64.54%
Poland	65.52%	64.45%
Israel	64.41%	64.41%
Canada	61.09%	62.62%
Portugal	61.07%	62.32%
Hungary	51.81%	58.53%
New Zealand	58.25%	58.25%
Australia	58.48%	57.82%
Austria	56.72%	56.33%
Italy	56.65%	55.59%
Netherlands	54.96%	55.05%
Ireland	56.54%	54.62%
Finland	54.96%	54.42%
Greece	55.34%	53.85%
Sweden	52.82%	52.82%
Norway	50.90%	49.50%
Switzerland	47.31%	46.48%
Belgium	44.41%	46.24%
Denmark	38.10%	38.10%

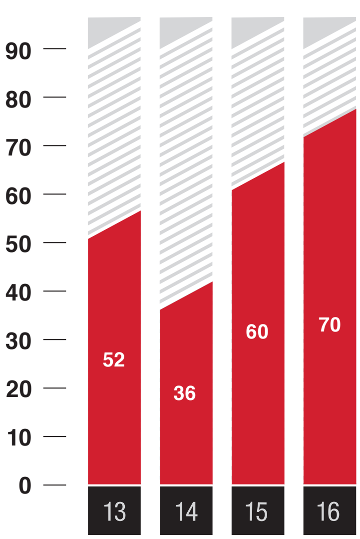
Source: Hewitt, P. (2011), "The Exercise of Shareholder Rights: Country Comparison of Turnout and Dissent." *OECD Corporate Governance Working Papers*, No.3, OECD Publishing, Paris.

THE ACTIVE PASSIVE INVESTOR

For years, we have warned not to paint all activists with the same brush and localize where an activist action or dissension against management could be initiated from. An activist action does not necessarily need to be precipitated by a traditional short-term activist. Today we see growing evidence that the world's largest investors have been stirred and issuers would be well served to forget their traditional categorization of investors.

Since 2015, there has been an increasing trend of withhold votes against directors on S&P/TSX Composite companies. As a result, there were a whopping 70 directors who received less than 80% support in 2016.

Number of S&P/TSX Constituent Directors Receiving Less than 80% Support (By Year)



As of December 31, 2016

Gone are the days when passive investors could be considered passive when it comes to governance or voting.

Index funds "can't sell those stocks even if they are terrible companies. As an indexer, our only action is our voice and so we are taking a more active dialogue with our companies and are imposing more of what we think is correct."
— Larry Fink, BLACKROCK

"We're going to hold your stock when you hit your quarterly earnings target. And we'll hold it when you don't. We're going to hold your stock if we like you. And if we don't. We're going to hold your stock when everyone else is piling in. And when everyone else is running for the exits. That is precisely why we care so much about good governance."
— F. William McNabb III, VANGUARD

What Is Changing at the World's Largest Investors?

Historically, passive index funds have bought shares in a company based on a proportion in a specific index, paying little attention to individual corporate strategy or management. But to think that passive institutional investors – from index funds to mutual funds to pension funds to sovereign funds – don't have the capacity or interest to watch over their massive portfolios would be a mistake. While you would be right that very few would initiate a proxy fight, more are willing to support an activist and even more are willing to vote against you on key governance issues.

While some large investors have long-held underlying funds with differing strategies, some with very active teams, passive investors as a whole have been increasingly pressured to push returns and are pursuing a more activist stance as a necessity, not simply a preference. Coupled with this, pressure has continuously mounted in a post-Enron world to ensure accountability and proper stewardship of shareholder dollars. Those whose money the passive funds manage want to be confident that underperforming companies, bad management, and governance laggards are being held accountable.

Gone are the days when passive investors could be considered passive when it comes to governance or voting. Those are now seen as key levers for long-term growth and, while there may have been some of this happening behind the scenes, passive investors have started taking more public actions. Passive investors who hold poorly performing stocks no longer need to face the binary choice of selling at a loss or continuing to be disappointed. The new option of influence to create the change you want has emerged. As BlackRock CEO Larry Fink has commented, index funds "can't sell those stocks even if they are terrible companies. As an indexer, our only action is our voice and so we are taking a more active dialogue with our companies and are imposing more of what we think is correct".[1]

By way of example, in the Americas, BlackRock reached out to companies that lacked gender diversity on the board and received shareholder proposals on the topic. Following the engagements, BlackRock supported eight of the nine shareholder proposals and voted against the nominating committee members at five companies for failing to address investor concerns related to board diversity.

Similarly, the Vanguard Group, Inc. has published examples of recent engagement efforts to promote change at their portfolio companies, including having a dialogue with a real estate company and an activist shareholder to encourage board change, and a successful engagement with a consumer products firm which led the company to make adjustments to executive compensation.

While engagement coupled with a large, long-term position can be enough to effect change, more and more passive investors are prepared to use their votes to send a message to directors and influence the direction of the companies they own, adopting a more 'longer-term activist' approach. Whereas checking a box used to be a formality, it is now a strategic choice passive investors understand can prove valuable in their search for alpha. Investors who are committed to a buy-and-hold strategy recognize that holding doesn't mean they have to accept the status quo. In fact, a long position likely increases their ability to influence changes and improve long-term performance.

As F. William McNabb III, Chairman and CEO of Vanguard, has said, "We're going to hold your stock when you hit your quarterly earnings target. And we'll hold it when you don't. We're going to hold your stock if we like you. And if we don't. We're going to hold your stock when everyone else is piling in. And when everyone else is running for the exits. That is precisely why we care so much about good governance."[2]

Institutional investors are directing more resources, time, and money into building internal governance teams and actively engaging the companies they own in the belief that high standards of corporate governance and transparency in reporting can help create value. BlackRock, Vanguard, and State Street have significantly grown their corporate governance teams. BlackRock, for example, now has the largest team, with 31 people dedicated to governance, while Vanguard has doubled its headcount to 20 over the last three years. In addition, Vanguard and State Street are reportedly poised for more growth in their governance departments this year.

This year, investors were explicit in their expectation that companies talk to them about changes on issues like environmental and social policies that will impact long-term shareholders. State Street, for example, was clear that they expect companies to talk to them about ESG risks. Although it is true that a lot of investors have had policies like this for a number of years, they were still willing to go along with management for the most part. For example, where previously Vanguard would abstain from voting on ESG proposals, its policy is now to vote case-by-case and it is pushing for greater environmental disclosure by issuers.

[1] "Passive investors are good corporate stewards", Financial Times, January 19, 2016
[2] F. William McNabb's keynote address at Lazard's 2015 Director Event, "Shareholder Expectations: The New Paradigm for Directors"

Setting the Agenda Without Casting a Vote

It's not just through their votes that passive investors have been directing the agenda. Even before a vote is cast, the disclosure of an institution's proxy voting guidelines can serve to influence change as issuers seek to meet their expectations rather than risk a vote against.

Institutions like the British Columbia Investment Management Corporation have updated their proxy voting guidelines on topics like climate risk reporting and may now vote against directors when the company is perceived to have inadequate disclosure or lack oversight, leading to environmental problems. BlackRock has also made climate risk disclosure an engagement priority for 2017–18, which may serve as an early warning for issuers on the topic, especially given the typical size of a BlackRock position in an issuer. As a result, we have seen more companies focusing on improving their disclosure in these areas.

The model of 'corporate access' has seen some inversion. In the past, institutional investors grappled to gain access to issuers in order to table concerns. With strengthened policies and governance teams, more and more issuers are now scrambling to understand shareholders.

In many ways, a vote may be an indication the preferred channel of influence – direct engagement with management and the board – failed. The Canadian Coalition for Good Governance has outlined its recommendations about how to "escalate engagement activities if a board is unresponsive to the concerns communicated" that go beyond withholding votes on directors and voting against say-on-pay to include making public pronouncements about their concerns and making their votes public. Tactically, this could include speaking at shareholder meetings, public letters, submitted shareholder proposals, requisitioning a meeting, nominating a director by proxy access (where available), and seeking governance improvements, including through possible legal remedies.

Public declarations such as letters or high-profile speeches by the likes of State Street and BlackRock have served to put issues like long-termism, corporate responsibility, and diversity on the top of issuers' minds. State Street, for example, indicated in March with a statue of a little girl standing up to Wall Street's famous bronze bull that it will start voting against nominating committee members who don't make a verifiable attempt to improve female representation on their boards.

In perhaps the most high-profile example of passive institutional action this year, a group of large pension funds, including the Canada Pension Plan Investment Board, Ontario Teachers' Pension Plan Board, and Caisse de dépôt et placement du Québec, publicly declared their intention to withhold support for Bombardier Inc.'s executive chairman in an effort to split his role in management and on the board.

This pronouncement was prompted by an increased frustration by the pension funds that concerns regarding big raises to top executives – after the company had taken government funding and additional loans, while having laid off thousands of employees – had not been heard.

Since the executive chairman's family founded Bombardier and maintained control through multiple voting shares, other shareholders were not only concerned about the independence of the company's management from its controlling shareholder but also the ability of minority shareholders with a substantial economic interest to influence change.

In this case, public embarrassment over concerns in governance resulted in the executive chairman giving up his management role. Because shareholder votes can only accomplish so much, such as provide advice on pay, public shaming could become a more common tool for driving change.

Impact of Institutional Activism

Academic research has found that an increase in passive ownership influences a company's governance choices, seeing an increased passive position associated with more independent directors, the removal of poison pills, fewer dual-class share structures, and more support for shareholder-initiated proposals.[3]

For companies, a withhold vote can serve to notify them they are on a short leash and changes are needed. Reviewing the policies of shareholders, not just the proxy advisors, can help mitigate voting risk and ensure companies are on the forefront of governance best practices.

For investors, the exercise of voting their views sends a signal across their portfolio to all companies, especially the smaller ones. If an investor like BlackRock votes against a mega-cap company, it serves as a warning to all companies in their portfolio that they need to be on top of the issues that triggered the withhold vote. Companies considered standard setters need to be especially aware of the active passive investor.

With the traditional lines between investment styles blurred, companies can no longer assume their traditionally quiet investors will meekly go along with management.

[3] "Passive Investors, Not Passive Owners", Ian R. Appel, Todd A. Gormley, and Donald B. Keim, December 18, 2014

DUAL-CLASS SHARE STRUCTURES: IF YOU DON'T LIKE THEM, BUY SOMETHING ELSE

Despite resistance from corporate governance experts and the majority of investors, increased scrutiny from regulators, and companies abandoning the structure altogether, more and more Canadian companies are going public with multiple classes of shares.

It's clear that founders of these newly IPO'd companies want access to public capital while retaining control, but some shareholders are asking if what it took to get the company to IPO is what the company needs to take the next step.

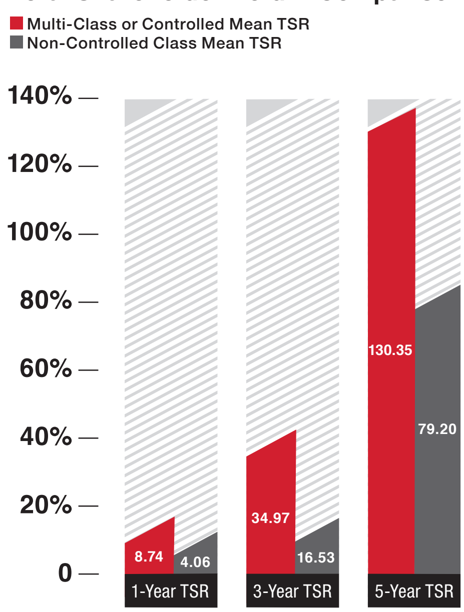
Why So Popular?

While critics will point out problems with a dual-class structure – like that the founder who can sell and then keep the company may not possess the expertise and skillset required to get it to IPO and beyond – the structure is popular.

Between January 1, 2015, and June 30, 2017, there were 28 IPOs, 18 of which were multi-class or controlled, representing approximately 64% of the companies. Notable Canadian names on the TSX include Spin Master, Cara Operations, Shopify, Aritzia, and Freshii. In short, the approach seems to be: if you don't like the voting structure, don't invest.

How are they able to afford such a bold stance? Well, it appears companies with multiple voting classes are getting results, at least in the short to medium term. Among the 60 largest companies on the TSX (S&P/TSX 60 Index), using the most recent performance trailing total shareholder return data, multi-class or controlled companies appear to be outperforming single-class or non-controlled companies.

Total Shareholder Return Comparison



As of August 31, 2017

On top of these numbers, qualitative arguments that a dual-class structure is important to keep the founder's vision intact and focus on the long term, not fluctuating quarterly numbers, make some sense.

Governance Concerns

Many investors have voiced their concerns about dual-class companies, with some large institutional investors, such as CalPERS, refusing to invest in IPOs with dual-class stock.

Concerns include the fact that there is a disproportionate amount of economic risk for subordinate shareholders and that super-voting shareholders can elect or replace board members, resulting in passive boards or entrenched management teams that face limited repercussions for their decisions.

With such a lack of oversight often found in corporate scandals, there are also concerns surrounding the ease with which one could misappropriate company funds, with the controlling executive shareholders' ability to withdraw funds and assets from the company via excessive compensation, self-serving transactions, or cash flow being diverted away from the business towards unrelated management projects, as well as inadequate succession planning.

Fundamentally, one has to ask which is the more pressing motivator: preserving the status quo or generating superior returns for subordinate shareholders? This can be even more pronounced for a corporation pivoting from growth stage to mature 'cash cow' stage when both the excitement and stock appreciation are waning.

View of Proxy Advisors

ISS believes that the fundamental tenet of shareholder democracy is the 'one share, one vote' principle. Naturally, the very thought of dual-class stock is counter to this. While there are limited circumstances in which ISS may support the creation of a class of common shareholders – including foreign ownership requirements, provisions the subordinate class may elect some directors and are able to approve a change-of-control transaction, and a sunset clause – ISS will generally vote against such proposals. In the case of a company controlled through a dual-class share structure, the support of a majority of the minority shareholders would equate to majority support under their board responsiveness policy.

Glass Lewis, on the other hand, generally recommends that shareholders support measures that would curb the disparity between economic and voting rights at public companies. In two recent cases where the extension of multiple voting shares with unequal voting rights were sought (Fairfax Financial Holdings (2015) and Alimentation Couche-Tard (2015)), ISS and Glass Lewis recommended against both. Ultimately, the proposal at Fairfax passed with a slim margin, whereas the proposal to amend the articles at Couche-Tard failed.

Interestingly, when multiple class share structures are collapsed, this may also be a point of entry for activists or contentious situations, as can be seen in the case of Mason Capital opposing TELUS' collapse of its dual-class share structure.

Considerations for Companies and Best Practices

For companies who have listed with multiple voting classes and are experiencing criticism, there are various ways to mitigate shareholder concerns: the introduction of sunset clauses; coattail provisions for change-of-control transactions; a maximum voting ratio of multiple voting shares to subordinate voting shares (such as 4 to 1, as recommended by CCGG); the use of strongly independent and unrelated board committees; and the elimination of any premium paid to multiple voting shares should the dual-class structure be collapsed.

For subordinate shareholders, there does not appear to be a practical way out. Shareholders understood what they were buying, so it is hard to force change – a fact that courts have pointed out when rejecting oppression cases. Given the limitations on the rights of the subordinate shareholder, perhaps a way forward is to allow for only professional investors to take positions in dual-class companies.

OUR ADVICE

(HINT: IT'S ALL ABOUT ENGAGEMENT...)

section

03.

UNDERSTAND THE EVOLVING ROLE OF PROXY ADVISORS

The role of proxy advisors, most notably ISS and Glass Lewis, is constantly evolving.

In this year's proxy season, we saw ISS and Glass Lewis tighten their policies and their application, which impacted the outcome of not only contested meetings but also standard annual and transactional meetings.

A mistake issuers make is thinking that what led to a positive recommendation last year – or even earlier in the current proxy season – will undoubtedly lead to the same outcome the next time around. This is not the case and you shouldn't have to see your vote fail to know the goalposts have moved.

For companies to position themselves optimally in the eyes of the proxy advisors and secure a positive recommendation, it is essential they have an in-depth understanding of how proxy advisors will view a proposed transaction, slate of directors, or other proxy proposals. Issuers need to get inside their heads and think like a proxy advisor. This is not easy, which is why an experienced, leading-edge strategic governance advisor is crucial when it comes to navigating the complex waters of ISS and Glass Lewis. A seemingly routine vote or deal can be completely derailed if the issuer doesn't have a thorough understanding of the nuances and considerations that go into the decision-making process.

Why Are Proxy Advisors Tightening Their Policies?

As subscribers to ISS and Glass Lewis, it is the large shareholders who help set the agenda; their needs and attitudes help to craft policies and determine how they are applied. As the expectations of shareholders change, so do the policies of the proxy advisors. For example, the introduction of ISS' Equity Plan Scorecard methodology is meant to reflect the increasingly diverse metrics institutions are using to evaluate equity plan proposals. Recall that in the past, ISS primarily focused on the cost of the plan.

Even if there is no formal policy in place, we know that having a proxy advisor subscriber coming out and publicly raising concerns about an issue can influence the proxy advisors to at least dig deeper or take a second look.

It is worth noting that on some contentious issues, the proxy voting guidelines of certain institutional investors may be even more stringent, using the issues identified by the proxy advisors as 'red flags' that require additional probing. For example, take equity plans. Even though an equity plan may be structured to satisfy the guidelines of ISS, institutions may vote against it after conducting their own analysis and taking a harder line on elements such as burn rate, dilution, plan cost, change of control, or the evergreen reserve feature.

Why the Proxy Advisors Will Continue to Gain Power

While the retail investor is unlikely to ever become fully extinct, signs indicate they are on their way to becoming an endangered species. It used to be that a typical TSX or Dow Jones issuer could count on its shareholder base to be made up of approximately half institutional investors and half retail investors. Today, a new generation of investors no longer invest in individual stocks for the long term, opting instead for mutual funds, index funds, or ETFs.

With mutual funds and ETF investors like BlackRock, State Street, Vanguard, Fidelity, Norges, and others now controlling trillions of dollars of investments, they, along with large pension funds and hedge funds, are eclipsing the retail investors, particularly in newer public companies. As subscribers to ISS and Glass Lewis, and the conduit for their vote recommendations, we can see how the importance of the proxy advisors' vote recommendation is quickly being magnified.

How Companies Can Prepare

Start with the end in mind. Know how proxy advisors will look at your situation and keep that in mind as you design your resolution or deal. Management needs to spend time with governance advisors who know how the proxy advisors think to prepare. A big part of this means understanding that the public policies of the proxy advisors are only one part of their evaluation. On virtually every recommendation, a qualitative assessment and human factor play a role.

A good advisor will tell you what the recommendation and resulting vote will be and what you can do about it. Companies should start by completing a risk assessment of how shareholders will react to proxy advisors' recommendations and the vote impact. As much as this will influence the design of your circular, more importantly it will influence your overall strategy. For example, in a proxy fight, what tactics do ISS and Glass Lewis frown upon? In M&A, what do they like to see in terms of strategic rationale, valuation, negotiation, and transaction process? Will they go beyond the deal and look at go-it-alone scenarios? Will they do their own work on the acquirer's pro forma financing as they did in CIBC's deal for PrivateBancorp? These are important questions upfront because it will be difficult to go back and revisit once you realize the proxy advisors have an issue.

In instances where negative recommendations are predicted, shareholder engagement should occur right away. From our experience, every shareholder is different: the policies, stances, and personalities of those actually casting the vote, whether portfolio managers or governance specialists, are all different. The one who made the decision to buy your stock may not be the one casting the vote. While the investment team and portfolio managers may help, governance specialists at institutional investors are key influencers on proxy voting matters.

It is worth noting that the rise of in-house governance teams at institutional investors has created a new paradigm for issuers and requires an extra layer of strategic design when considering proxy items. Additionally, some shareholders subscribe to one or more proxy advisors but don't necessarily follow their recommendations strictly. If there does happen to be a negative recommendation, all is not lost, but how you respond and position yourself following the recommendation is crucial.

For all the time and effort boards and management put into designing and de-risking proxy items or transactions, doesn't it make sense to make sure proxy advisors don't have the opportunity to derail your vote?

THERE'S NO SUCH THING AS A FRIENDLY DEAL

The days of the straightforward, friendly deal are over. Even the most seemingly routine merger or plan of arrangement now comes with an increased set of risks. The fact is a friendly deal can no longer be counted on as a 'sure thing'. Activists who specialize in 'bumpitrage' and long-term shareholders not happy about a deal's valuation have had a significant impact over the last few years.

When you consider the time, money, and effort that go into just getting to the announcement of a transaction, doesn't it makes sense to understand, consider, and prepare for those – from activists to your own shareholders to the proxy advisors – who could derail your deal?

How Activists Plan to Impose Themselves on Your Deal

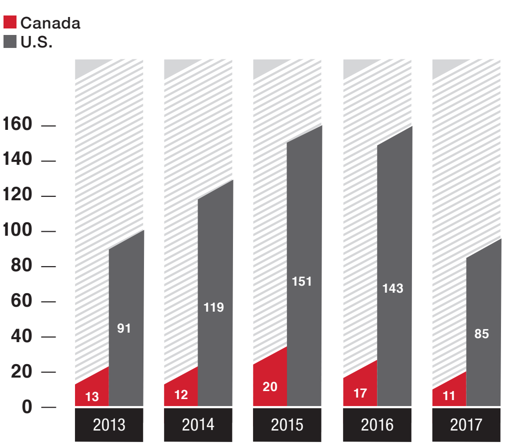
Picture this. You've just spent nine months conducting due diligence, pouring through mountains of corporate data and financial models, preparing to make a takeover offer. Your A-team of advisors is lined up, you've secured financing, and your offer is ready to go. After a few rounds of friendly discussions, the time has finally come – you've negotiated a merger between your company and a sought-after competitor. The finish line is in sight and all you need are a few more industry checkmarks, a court stamp of approval, and 66⅔% of shareholder votes cast to support your view of the future combined company.

Now flash forward to your joint-deal announcement – the premium offered is high relative to historical trading and first reports from the analyst community are positive. Your long-term shareholders seem to like the deal and things could not be going better. But wait: two weeks later, an activist press release suggests that your sought-after deal isn't so great after all and not only do they want more – their support group of your shareholders does too.

What was once a simple cog in the transaction wheel has become one of the most difficult approvals in the M&A process. Last year, the value of Canadian M&A hit $331 billion, up from $276 billion in 2015, helped in part by cheap financing and lofty valuations, with 160 companies in the U.S. and Canada subjected to M&A-related public activist demands.

While public activist campaigns continue their downward trend in 2017, we have seen an increase in shareholder intervention in transactional matters in 2016 and 2017, including Catalyst Capital Group's attempted block of the $2.56 billion acquisition of Shaw Media by Corus Entertainment Inc.; Oaktree Capital Management's successful blocking and renegotiation of the $1 billion acquisition of Tembec Inc. by Rayonier Advanced Materials; Van Berkom and Associates' attempt to block the $350 million going-private transaction involving Sirius XM Canada Holdings Inc.; and Smoothwater Capital's intervention and eventual settlement in the $59.8 million acquisition by Alberta Oilsands Inc. of Marquee Energy Ltd.

Number of M&A-Related Public Activist Demands



As of August 1, 2017. Demands include: push for merger, push for sale, push for acquisition, oppose acquisition, oppose merger/takeover, oppose terms of merger/takeover, push for company division, push for spinoff, take over company. Demands taken from regulatory filings, press releases, public letters, and interviews. Source: Activist Insight Online

TOP 10 LIST TO BLOCK A COMPANY VOTE

01. Run merger model with peer performance analysis

02. Analyze deal terms (length, approvals, etc.)

03. Talk to industry peers, experts, thought leaders on their views of the industry

04. Define strategy for putting pressure on issuer (i.e. come out early and loud, wait for certain approval hurdles to be cleared before voicing concerns)

05. Identify shareholders – call/meet with top 5–10 and gather their thoughts

06. Accumulate blocking position or partner with like-minded shareholders

07. Contact company – CEO, CFO, IR to drill down on details of the offer

08. Establish yourself as an expert and build credibility with target/seller – have to cast a shadow of doubt across all parties

09. Run aggressive PR campaign against the deal

10. Negotiate better deal or alternate beneficial outcome

Is This Sabotage? No, It's Bumpitrage

Bumpitrage, a form of event-driven arbitrage, occurs when an activist investor purchases shares in a target company for the sole purpose of blocking or manipulating the vote/tender process to push for a higher price.

These investors see themselves as real-time matchmakers who work with all parties involved to get a solution. In their eyes, it's simple: every buyer wants to buy something at the lowest price they can get and it's their job to make sure they pay as much as possible. Of 69 opposed mergers in North America since 2013, there were 19 that ended up increasing their offers to appease these shareholders, with an average increase of 21%.

How Do Bumpitrage Artists Pick a Target?

Surprisingly, the process of picking a target is not as complex as you might think. On the day of your deal announcement, the activist begins running various work streams with analysts, creating internal merger models comparing the deal's valuation to public trading valuations of peers. Precedent deals, peer performance, asset intrinsic value, and going concern value are the most important metrics. In essence, they are gut-checking the work your bankers did to structure the deal.

If a deal is undervalued or does not ascribe value to near-term positive developments, then the activist may have a case to sell or a case to hold if the deal is unsuccessful; otherwise, they need an exit strategy.

How you've structured your deal will play a critical role in their analysis, as shorter deal cycles are always preferred. For example, with a plan of arrangement typically taking 50–60 days from the announcement, arbitrage funds can purchase voting shares after the announcement but prior to the record date, giving some control over the process. Compare that to a tender at a minimum of 105 days where shares can trade hands at any point in time, impacting the ultimate tender. Necessary government approvals are also considered vis-à-vis timing and success.

On a parallel stream, the activist begins calling and meeting with your largest shareholders to enquire about their views of the deal and start sowing the seeds of discontent. Are they happy with the process? What was their original investment thesis and does this arrangement satisfy their needs? Could they support another structure?

The results from these calls and meetings will dictate whether the activist inevitably pushes ahead with their blockade, because they can't do this alone. While small-cap bumpitrage provides the opportunity for these funds to pick up a large and influential stake relatively easily, targeting large-cap companies requires marshalling support from other investors to secure a blocking position.

Historically, the next step was simple: look for a large, credible institution that would be interested in being the public voice. The frontman. A long-term shareholder that will exude credibility in the eyes of the proxy advisors who favour the long-term/constructivist style to the short-term/event-driven strategies. Ideally, this is someone who can stand up and say that they've owned the stock for ten years and while they like management, they don't like the deal.

However, what we are increasingly seeing today is the rise of the 'RFA' or 'request for activism' as long-term traditional money managers look for activists and event-driven funds to take on the role of the agitator. Though they may not like the deal privately, their public image is important and having an activist do the 'dirty' work helps them save face. Neuberger Berman, a longtime steward of pension funds and retirees, approached multiple hedge funds this year after their conversations with Whole Foods went stale, to put pressure on the company. Weeks later, JANA Partners announced itself as the second largest shareholder of Whole Foods pushing for and ultimately achieving sale of the company.

The Role of Proxy Advisors in M&A

In a merger, the battle for ISS and Glass Lewis support is fought well before the advisory reports are issued. Activists know this. They reach out to your larger shareholders who pay for the proxy advisors' recommendations and have them call ISS and Glass Lewis directly to talk about why they don't like the deal.

While a credible long-term institution like BlackRock or Fidelity may not be open to publicly supporting the activist, they might be more willing to pitch their view directly to ISS and Glass Lewis. From the activist perspective, this can make the difference. Since 2014, ISS has more than doubled the number of M&A transactions it has recommended against. Glass Lewis has been more aggressive historically in terms of recommending against M&A transactions compared to ISS. There may be a couple of reasons for this. The first may be due to the overall increase in M&A shareholder activism. The more transactions that are subject to activist attack, the higher the likelihood ISS and Glass Lewis will apply heightened scrutiny, thereby triggering an increased likelihood they will recommend against the transaction.

The second may be the reflection of the expectations of their institutional clients. There has been an increasing trend of institutions who have adopted a case-by-case approach in evaluating M&A transactions. This could require ISS and Glass Lewis to produce more in-depth and higher quality analysis for transactions, as opposed to applying a black-and-white policy guideline approach on routine governance items. In addition, what companies sometimes don't appreciate is that an ISS or Glass Lewis client might call or email feedback on a deal to the proxy advisor, and that will be sufficient for them to take a deeper look. *(See the cases of Tembec Inc. and Milestone Apartments REIT on page 9.)*

It is worth noting that ISS and Glass Lewis typically do not put too much weight on fairness opinions without detailed financial analysis. Instead, they place more emphasis on the transaction process: the time taken, the number of financial advisors retained, potential buyers spoken to, etc. However, in a contested situation, the non-disclosure of the details of the fairness opinion could put management in a disadvantaged position through the proxy advisors' lens especially if the activist shareholder demands such disclosure and questions the valuation assumptions of the fairness opinion. If detailed disclosure isn't made available, the analysis and assumptions will be left open for discussion.

Why My Deal? My Offer Was Full, Fair, and…

It's market practice now that anything that isn't labelled "best" and "final" is met with skepticism. An activist will always see room to increase unless it is strongly indicated otherwise by the bidder. Bidders today are very careful to guard themselves with their language and leave something on the table in case their first offer gets railroaded.

If the activist is successful in convincing the shareholders but ultimately not the bidding party that the deal is undervalued, it could result in considerable failure. Activist investor O'Hara Administration Co. put pressure on ALFA, S.A.B. de C.V., and Harbour Energy Ltd. in their bid to acquire Pacific Rubiales but failed to generate an increased offer. This resulted in the share price falling 45.8% following the bid being pulled and total loss of value when the company filed for creditor protection under the CCAA.

What Boards Can Do

A number of steps can be taken to ensure deals are more resilient. As the deal is announced, boards should recognize how fast things will move. The announcement is just the start, not the end, of your campaign. Third parties are prepared to criticize the terms of the deal faster than ever before.

Know your shareholder base and the valuations they put on your business. Without a larger institutional shareholder supporting them, activist investors will be hard pressed to derail your deal. Shareholder engagement is imperative to understanding the thesis of your investors and the targets they have; if the deal doesn't reach their valuation target, it is likely they will vote in support of the activists. Build relationships with the investors that matter and continually maintain dialogue. Activist investors are sophisticated and as their credibility continues to strengthen, so does the effect of their message on fundamental shareholders.

Voting lock-ups are one possible step. If not, acknowledging the challenge of selective disclosure, talk to the shareholders most likely to have reservations – and do it early and often, especially if their opinions are influential. In planning a merger with Dow Chemical, DuPont did just that, inviting Trian Partners to comment on the structure of the deal privately At the end of the day, a bidder having lock-ups, even if 'soft', can be a crucial element of the deal.

If an activist emerges, the board should immediately activate its already developed contingency plan as well as a communication plan. Consideration of next steps should be focused on the activist's critiques and expected traction they will find with shareholders. Management then must consider the expectations of the activist, for instance if the premium is 30% and the activist wants a 45% premium.

Activists might also press for a standalone process. Management might have its reasons for wanting to accept an offer. For example, if a business is in the midst of a difficult turnaround, show the activist the facts, asking their advice on how to approach the turnaround. Perception is often different from the reality, but people tend to be greedy. Explaining the downside risk and liquidity advantages of staying independent can help.

While boards have grown increasingly prepared for activism across the boardroom table, the same rigour and forward planning now need to be applied to the deal table.

CHECKLIST FOR 'FRIENDLY' DEALS

As one activist who recently derailed a transaction remarked, "Process will protect you from the courts but not from shareholders."

A holistic approach is required that considers advanced planning and issues that may emerge after your deal is announced – yet can be pro-actively addressed. Here is a top ten list to help boards prepare.

01. Prepare for an activist by viewing the deal through shareholders' eyes, looking for weaknesses

02. Monitor trading activity prior to the deal, considering how the deal impacts the goals of buyers

03. Take the temperature of your shareholders as soon as a deal is announced

04. If an activist does emerge, understand how their objective will resonate with other shareholders

05. Consider a settlement or confidentiality agreement

06. Emphasize the robustness of the strategic review process in your proxy statement

07. Explain the strategy and downside risk to other courses of action

08. Prepare to engage with proxy advisors, provide solid backup for valuation assumptions

09. Equity analysts carry more weight than your financial advisor

10. No deal is safe – be able to "show and tell" how and why it is a good deal

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