KINGSDALE
Advisors

CELEBRATING FIFTEEN YEARS OF CLIENT WINS
15
ESTABLISHED 2003

2018 Proxy Season Review

Encountering the Changing Expectations of Investors

CELEBRATING FIFTEEN YEARS OF CLIENT WINS

15

ESTABLISHED 2003

Unless otherwise stated, the source of data used in tables and charts in this report is Kingsdale Advisors, August 15, 2018.

Some percentage charts may not sum to 100% due to rounding.

All dollar figures are expressed in Canadian dollars unless otherwise specified.

2018 marks Kingsdale's fifteenth anniversary, representing not only a significant occasion for our company but also, more importantly, a significant milestone in our relationship with our clients.

While a lot has changed since our beginnings in 2003, our commitment to delivering the best service and unparallelled results for our clients remains the same. It's why, year after year, North America's top companies keep coming back to Kingsdale as their most trusted strategic advisor.

In the pages that follow, we've put our fifteen years of experience to use by taking a deep dive into the 2018 proxy season. Our aim is to provide a comprehensive overview of the landscape, ask tough questions about what the latest developments mean for our clients, and identify trends before they are trends.

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

- *We highlighted the emergence of ESG and predicted that responsible investing will move from the peripheral to mainstream focus. This year, we saw a record number of majority-supported ESG proposals in the United States and a strong reception to proposals in Canada.*

- *We emphasized the heightened level of proxy advisor scrutiny on say-on-pay but noted that a negative ISS recommendation did not necessarily mean the end of the line. In 2018, it appears that shareholders are more willing to go against proxy advisor recommendations when it comes to compensation issues.*

- *We waved the red flag when it came to the use of vote buying in proxy battles. This spring, the Canadian Securities Administrators (CSA) sought comment on the use of soliciting dealer arrangements both in the context of mergers and acquisitions and proxy fights.*

Just over halfway through this year, we're on pace for more proxy fights, with new battles surfacing daily. This confirms a point we have made in previous years: there is no such thing as a proxy season. Not only is vigilance required year-round, but more importantly, so are sound governance practices, including proactive shareholder engagement.

We hope you find this report useful as you plan ahead and prepare for the most unexpected challenges.

We remain on standby, ready to assist when you need us the most.

Best regards,

Wes Hall, ICD.D
Executive Chairman & Founder

Amy Freedman
Chief Executive Officer

1 Proxy Season Review

Proxy Contest Overview

Activism remains at elevated levels

Throughout the years, we've seen a large increase in the number of public proxy contests in Canada, from six in 2003 to a peak of 55 in 2015. While we likely won't reach 2015 numbers, 2018 is on pace to be another eventful year.

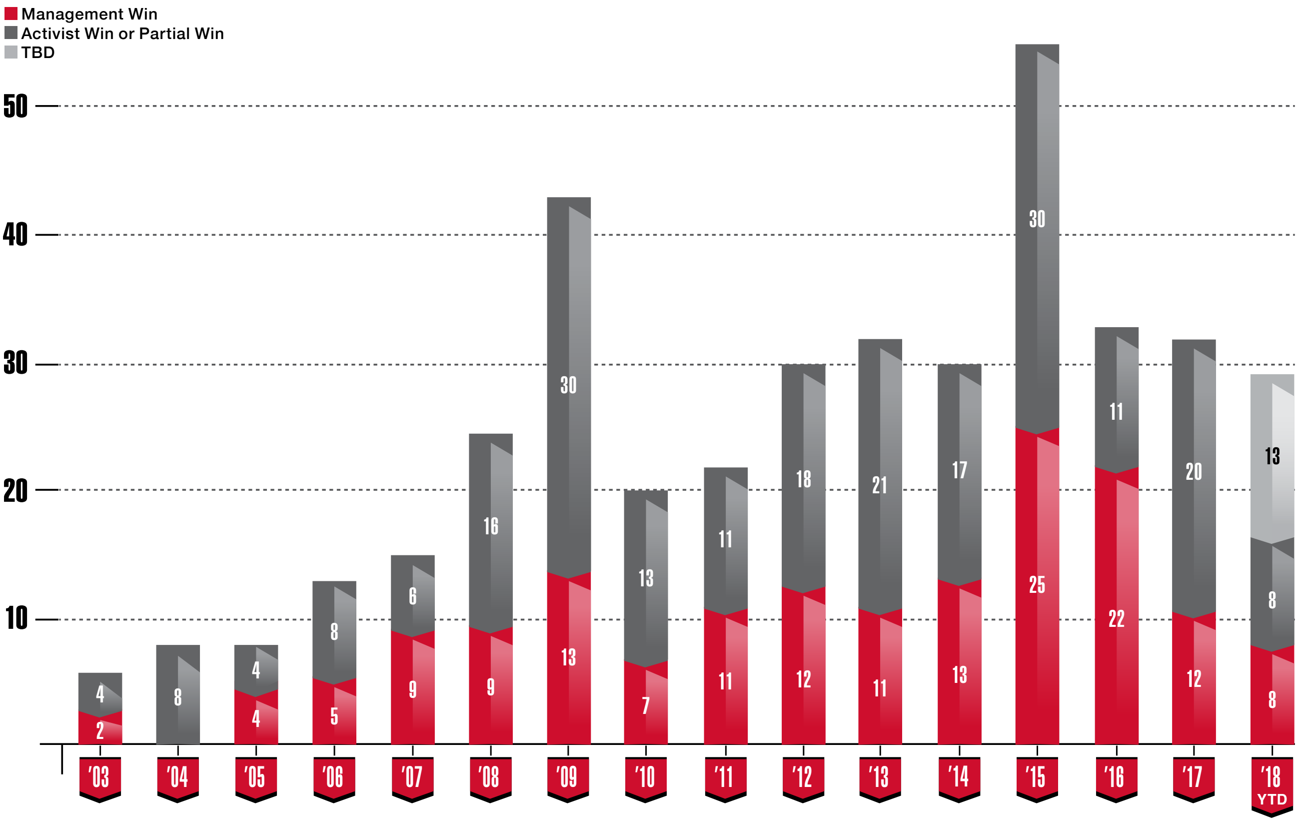
Year-to-date activity has exceeded last year's figures: this time last year, there were 21 public proxy contests, increasing to 32 by year-end. Comparatively, there have already been 29 proxy fights in 2018, and new battles continue to surface daily.

Clearly, activism continues to be a popular investment style and an important tool for investors looking to extract value or halt what they see as value erosion. Consequently, Canadian companies need to remain vigilant and maintain plans for addressing activist shareholder attacks.

Of particular note this year, we have observed more proxy fights being initiated after the so-called conclusion of proxy season, reinforcing a point we have made in previous reviews: there is no longer a proxy season, so heightened vigilance is required year-round.

Figure A

Number of Proxy Contests in Canada
2003 - 2018 YTD



We continue to reiterate that while the number of fights may have decreased from the 2015 peak, that is largely a function of the behind-closed-doors engagement that is taking place between activists and companies. Public activism is not always the goal nor the result of an interaction with a concerned shareholder.

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. Based on our deep industry experience, we estimate that only one-third of proxy fights ever become public.

Activist Success Rates Falling in Canada but Rising in the U.S.

Years ago, we branded Canada as the land of milk and honey for activists, and for years, this has been the case. Not just because of the structural regulatory advantages that exist, but also because of a sustained period of victories for activists. But now it looks like things might finally be starting to change, even accounting for the small sample size to date this year.

So far in 2018, activists in Canada have won 50% of the proxy contests compared to a 63% success rate for all of 2017. Interestingly, the activist win/loss ratio differs greatly from what's happening in the U.S. where, this year, the activist win rate stands at 72% according to Shark Repellent.

This inverse trend between Canada and the U.S. may be due, in part, to the difference in marketplace dynamics. Delaware law allows a company to not give an activist the right to call a special meeting, raising the bar of what is required when launching a proxy fight and helping to ensure that campaigns are very well thought out and planned prior to launch. The U.S. also houses larger and more experienced activist players who have the deep pockets, know-how, and teams needed to force a victory in even the most challenging fights.

Conversely, in Canada, public companies have become increasingly well-defended as the market has been educated about how activist-friendly of a jurisdiction

WHAT COUNTS AS A PROXY CONTEST?

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 (from a planted news story to a press release to a 13D), requisitions a shareholder meeting, publicly announces an intention to nominate alternate directors, solicits alternative proxies, conducts a "vote no" campaign on either the election of directors or M&A transactions, 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. In other words, if a shareholder says it has publicly targeted you, we consider the fight to be on.

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.

WHAT COUNTS AS A WIN?

For activists seeking board representation, an activist win is defined as the activist achieving a majority of its objectives. For example, the activist asks for three board seats and receives two. A partial win is if an activist receives any of its asks. Conversely, a management win means an activist receives nothing.

Canada is seen as. Even smaller companies are cognizant of the activist playbook and have taken steps to protect themselves.

Given the smaller pool of Canadian directors *(a topic we cover in greater detail on page 50, Hot or Not? Being a Director)*, we have seen a lot of directors with repeated experience in dealing with activists – an experience that brings not only the know-how but also the chops needed to stare down an activist.

In addition, given that Canada has fewer structural defences available to companies, boards are more willing to take proactive actions on board composition, management team changes, and business strategy. This means the incumbent may enjoy the benefit of the doubt from shareholders, making it harder for the activist to make the case for change.

Most Active Sector Analysis

Proxy Fights by Sector

The materials sector is, once again, the most active for proxy battles in Canada, likely representative of the high number of extractive companies amongst the TSX.

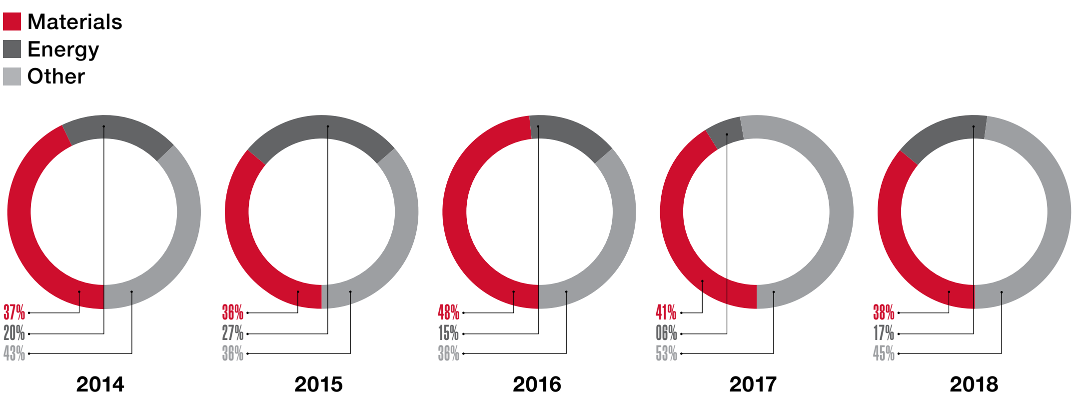
One of the most publicized materials sector contests this year is the ongoing battle between U.S.-based hedge fund Paulson & Co. and Detour Gold Corporation. In the summer, Paulson & Co. initiated a public campaign against Detour Gold pushing for a sale of the company and requisitioned a meeting to replace the entire board.

The second most active sector in 2018 is the energy sector, regaining its position following a dip in 2017. Clearly, depressed oil prices in 2017 discouraged activists from deploying capital in a sector significantly levered to the commodity cycle. Now, in 2018, oil companies whose stock value fails to keep pace with rising oil prices are seen as weak performers, opening themselves up to activist attacks.

This was the case in the energy sector's most high-profile activist fight of the year. In April, Cation Capital (a newly founded, one-man-show activist) launched a last-minute proxy battle in an attempt to replace four directors at Crescent Point Energy's annual general meeting. Despite proxy advisor Institutional Shareholder Services' (ISS) support for two activist nominees, all incumbent Crescent Point Energy directors were elected at the meeting. *(You can read our case study on this fight on page 14.)*

Figure B

Most Active Sectors Trend Analysis **(As a Percentage of Total Proxy Fights by Year)**



Activist success rates in the energy sector have declined significantly from 50% in 2017 to 0% in 2018 while activist success rates in the materials sector have declined from 77% to 40% *(see Figure C on the next page)*. This can partially be attributed to increasingly well-defended issuers and shareholders realizing the inherent difficulties of enacting change in a fluctuating commodity price environment.

We have observed that activist losses in this space suffer from some common themes: inability to make a compelling case for change; inability to attribute a real decline in value to the board and management directly vs. external factors; and lacklustre board nominees. Activist campaigns that share these characteristics have a difficult time branding themselves and their plan, and often fall victim to "better the devil we know" thinking by shareholders.

Figure C

Activist Success Rates in Energy and Materials Sectors

Energy	Management Win	Activist Win/ Partial Win
2018	100%	0%
2017	50%	50%
2016	40%	60%
2015	73%	27%
2014	50%	50%
2013	37%	63%

Materials	Management Win	Activist Win/ Partial Win
2018	60%	40%
2017	23%	77%
2016	69%	31%
2015	40%	60%
2014	46%	54%
2013	37%	63%

Figure D

Number of Proxy Fights by Sector and Win Rate Analysis

SECTOR	2018	2017	2016	TOTAL
Consumer Discretionary	3	3	2	8
Industrials	1	1	2	4
Consumer Staples	0	1	1	2
Health Care	1	2	1	4
Financials	1	1	2	4
Information Technology	1	4	3	8
Telecommunication Services	0	0	0	0
Utilities	1	1	0	2
Energy	5	2	5	12
Materials	11	13	16	40
Real Estate	2	3	0	5
Other	3	1	1	5
# of Proxy Fights	29	32	33	94

	2018		2017		2016	
SECTOR	Management Win	Activist Win/ Partial Win	Management Win	Activist Win/ Partial Win	Management Win	Activist Win/ Partial Win
Consumer Discretionary	0%	100%	67%	33%	100%	0%
Industrials	0%	100%	100%	0%	100%	0%
Consumer Staples	nil	nil	0%	100%	100%	0%
Health Care	0%	100%	100%	0%	100%	0%
Financials	100%	0%	100%	0%	0%	100%
Information Technology	100%	0%	0%	100%	67%	33%
Telecommunication Services	nil	nil	nil	nil	nil	nil
Utilities	0%	100%	100%	0%	nil	nil
Energy	100%	0%	50%	50%	40%	60%
Materials	60%	40%	23%	77%	69%	31%
Real Estate	50%	50%	33%	67%	nil	nil
Other	nil	nil	0%	100%	100%	0%
Overall Success Rates	50%	50%	37%	63%	67%	33%

PROXY CONTEST HIGHLIGHTS AND SHOWCASE

Transaction- vs. Board-Related Proxy Contest Count

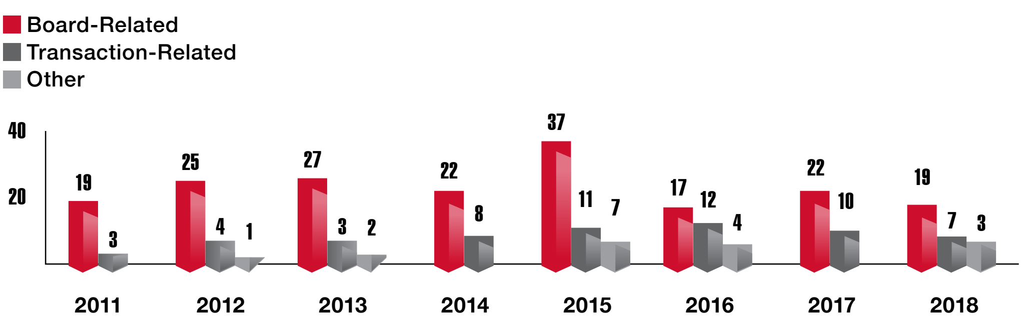
In 2018, the percentage of board-related proxy contests for declared fights decreased slightly to 66%, but is still up from the low of 52% in 2016. The consistent proclivity towards board-related fights is, in part, due to the recognition by activists and potential acquirers that the easiest path to transact may be by first replacing the board. This is especially true under the new takeover bid rules.

The extended 105-day bid period means increased uncertainty, which may limit the desire of acquirers to go hostile and, at the same time, encourage activists to try to work a deal from the other side.

What better way to eliminate that uncertainty than by "engineering" a friendly transaction. This appears to be the case with Detour Gold, where the activist, Paulson & Co., wants the company to launch a public sales process. Management did not yield to the demands and, as a result, a proxy contest was launched to replace the entire board of the company with directors who would presumably be more amicable to a sales process, possibly even with a specific suitor in mind.

Figure E

Transaction- vs. Board-Related Proxy Contest Count



Note: "Board-related" contests represent the following campaign types: board control and representation, remove director(s), and remove officer(s). "Transaction-related" contests represent vote/activism against a transaction, excluding campaigns that seek for both transaction and board changes. "Other" contests include withhold campaigns and other campaigns seeking to enhance corporate governance and maximize shareholder value.

Board-Related Fights — A Deep Dive on Slate Type

Since 2011, Kingsdale has tracked the number of times an activist in a board-related fight has put forward a majority slate versus a minority slate. This year, we see a similar trend as in 2017, with minority slate usage hovering around the 21% range. Based on our analysis, the type of slate an activist uses has some correlation with its share ownership. Generally, the greater the ownership, the more likely it is that an activist will use a majority slate.

For example, in the proxy contest launched against DavidsTea Inc., co-founder and former director, Mr. Herschel Segal, solicited for the replacement of the entire board while holding approximately 46% control. Alternatively, in the case of Cation Capital against Crescent Point Energy, Cation Capital only held 0.3% of the outstanding shares, and nominated a minority slate – though pursuing four of 10 directors is a bold call. As can be seen in Figure G, slate type does not truly have correlation with win rates.

Deciding which slate type to use is pivotal to an activist's strategy. In cases where there is a large institutional shareholder base which de facto results in significant ISS and Glass Lewis influence, activists need to consider the proxy advisory firms' framework when building their slates.

For example, a majority slate will require a detailed activist business plan as well as a management transition plan, whereas a minority slate will require a less stringent threshold.

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.

Figure F

Activist Slate Types **(As a Percentage of Total Board-Related Proxy Fights)**

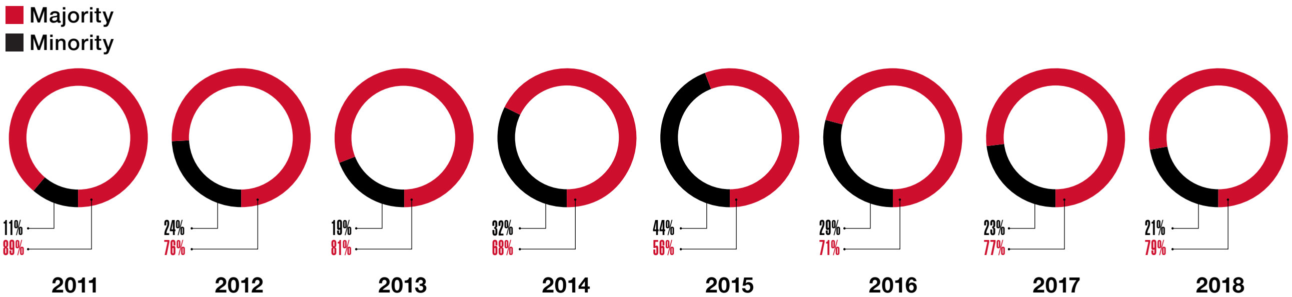
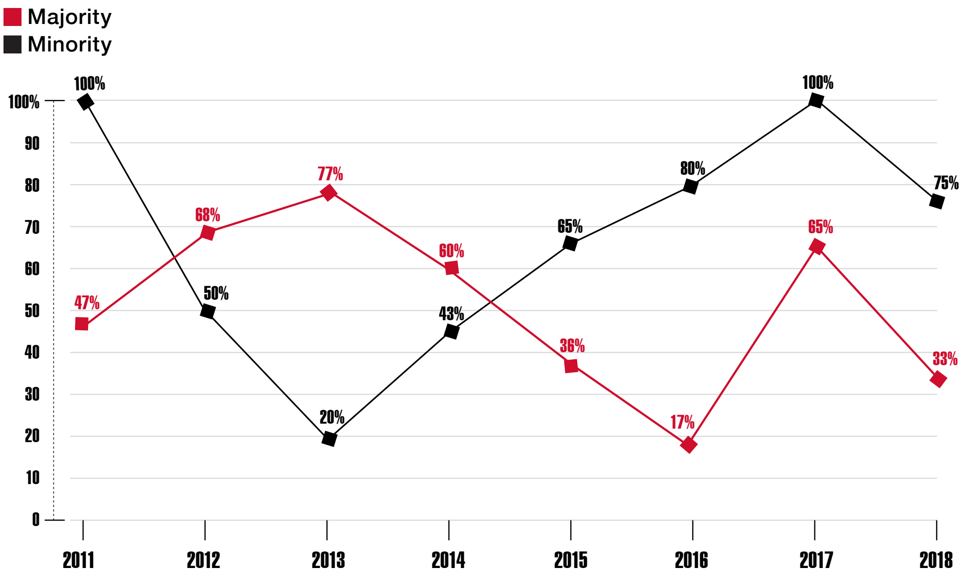


Figure G

Relationship Between Activist Slate Type and Activist Win **(As a Percentage of Instances Where Each Slate Type Was Used)**



Up-and-Coming Sectors and Predictions

This year, blockchain and cannabis are the two hottest sectors in Canada, captivating investors with their growth potential. Just because these industries are in their respective infancies, however, doesn't mean that they're immune to proxy contest activity, especially transaction-related proxy contests. With the volatility and the highs and lows in these sectors, there is bound to be criticism of the underperformers, as well as divergent shareholder views on the appropriate growth path or exit strategy. These high-growth companies generally lag on corporate governance best practices as well. *(See our article In The Crosshairs: REITs, Cannabis Companies Poised to Be Activist Targets on page 43.)*

In May 2018, Hiku Brands and WeedMD agreed to a merger, only to have Canopy Growth, an industry leader, submit a superior proposal to acquire Hiku Brands.

Late last year, Aurora Cannabis launched an unsolicited bid for CanniMed Therapeutics, which eventually turned friendly in 2018 after a sweetened offer. Given the boom in the cannabis industry, we believe competing and/or hostile bids in this sector will continue. (*See our article Pot Shots: What CanniMed's Poison Pill Defence Against Aurora Means on page 26.)*

While not as frequent, we've also started to see board-related fights in these industries. Earlier this year, Ms. Penny Green, a former COO and director of Glance Technologies (a company involved in both blockchain and cannabis-related technologies), launched a proxy contest to reconstitute the company's board.

Return of the Founder or Insider

In 2018, we've seen a significant number of former founders or insiders launching proxy contests against companies they are, or were once, affiliated with. These events represent unique challenges for issuers, given that former insiders have access to information that an outside activist would not, including the identity of shareholders as well as operational and financial knowledge.

ISS' Changing Views: Last-Minute Proxy Contests and Proportional Representation

Earlier this year, Cation Capital launched a proxy contest against Crescent Point Energy, a leading North American oil producer. While an activist launching an attack against an oil company isn't unique in itself, Cation Capital and its strategy was.

Just a few weeks prior to Crescent Point Energy's annual general meeting, Cation Capital was formed and, with a mere 0.3% share ownership, submitted a minority slate pursuant to Crescent Point Energy's advance notice by-laws, just one day before the deadline.

As ISS' policy does not require "a detailed plan" when dissidents seek a minority of the board seats, the key requirement is that new nominees can add value to board oversight. In this case, ISS believed that two directors from the management slate with independence issues and lack of (what it considered) relevant experience should be replaced by activist nominees with substantial public board experience. ISS supported two of four nominees, paying very little attention to the credibility of the newly formed fund and the investment duration, but rather placing significant weight on relative underperformance. Glass Lewis, on the other hand, did not support any of Cation's nominees, appearing to have accepted management's claims of ambush.

Issuers should take heed of the Crescent Point Energy case. Low share ownership, relatively recently accumulated position, as well as last-minute ambush tactics may very well be justifiable to proxy advisors if a strong case for change has been made. Companies with historically weak total shareholder returns and a board that lacks skin in the game are especially vulnerable to these tactics given that shareholders may be fatigued by corporate rhetoric and have a desire for change.

In the Crescent Point Energy case, management was able to ensure that the entire incumbent slate was re-elected by using independent directors to talk to shareholders directly and effectively explain the risk of appointing nominees misaligned with their interests, the lack of additive expertise of the new nominees, and the changes that had already occurred at the board level. The lack of credibility of the activist also resonated with investors.

TO DATE, IN 2018, WE'VE SEEN AT LEAST SEVEN CONTESTS LAUNCHED BY FORMER INSIDERS

- **DavidsTea Inc.**
  ACTIVIST WIN
  Rainy Day Capital (controlled by co-founder and former director, Mr. Herschel Segal), against DavidsTea Inc.
- **Viridium Pacific Group**
  ACTIVIST WIN
  E&R Holdings Ltd. and concerned shareholders, including former consultant to the company, Mr. Sean MacNeil, against Viridium Pacific Group
- **Alexandria Minerals**
  MANAGEMENT WIN
  Mr. Eric Owens, former CEO of the company, against Alexandria Minerals
- **Colorado Resources**
  ACTIVIST PARTIAL WIN
  Mr. Adam Travis, former CEO of the company, against Colorado Resources
- **Glance Technologies**
  MANAGEMENT WIN
  Ms. Penny Green, former executive and director of the company, against Glance Technologies
- **Karnalyte Resources**
  MANAGEMENT WIN
  Mr. Robin Phinney, former CEO of the company, against Karnalyte Resources
- **Getty Copper**
  TBD
  Mr. John Lepinski, former CEO of the company, against Getty Copper

Compensation Issues as a Springboard to Activism

Management and board compensation levels remain a key governance weakness that activists continually target during their campaigns. How much board and management pay themselves has — fairly or not — become a symbol for whether or not management is aligned with shareholders.

This was a key tactic used by Cation Capital in its proxy battle against Crescent Point Energy: Cation Capital criticized Crescent Point Energy's compensation schemes, reminding shareholders of the company's 2016 failed say-on-pay vote. Notably, as a result of the contested solicitation against say-on-pay in 2018, with an against recommendation on Cation Capital's proxy card, Crescent Point Energy failed its say-on-pay vote for a second time with only 38.52% support.

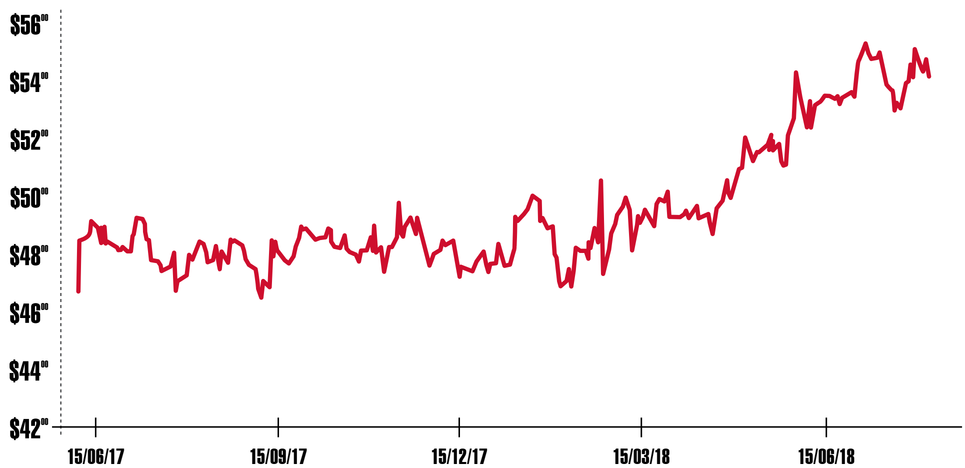
We've also seen companies run into issues with ISS' Relative Degree of Alignment test, which measures total shareholder return performance rank relative to CEO pay rank. A low Relative Degree of Alignment score is indicative of an underperforming company with high pay, and a company with sustained low scores over multiple years can become vulnerable to an activist.

Granite REIT — One Year Later

Once the media coverage dies down, it is rare, but useful, to have the opportunity to go back and look at how high-profile proxy contest victories have fared for investors. One of the most prominent proxy battles in 2017 was at Granite REIT, where activists FrontFour Capital and Sandpiper Group successfully made the case for change. So far in 2018, it looks like the change the activists sought is bearing fruit.

Figure H

Granite REIT Stock Performance **(Since 2017 Annual General Meeting)**



Principal activist arguments during the proxy contest included: high director compensation; the inefficient capital structure (low debt of which leverage could be used to unlock value); and high focus on Magna-tenanted properties.

Immediately after the appointment of three activist nominees at the unitholder meeting on June 14, 2017, a board meeting was held to reduce trustee compensation by another 20% effective January 1, 2018. While leverage (net debt to fair value of investment properties) remains well below the 40% target (as of April 2018), Granite REIT had made significant progress in reducing Magna concentration to 51% as a percentage of gross leasable area (down from 61% as of Q4 of 2017).

The trustees have also recruited a new CEO, Mr. Kevan Gorrie, the former CEO of Pure Industrial REIT (PIRET), who had successfully closed the sale of PIRET to Blackstone and Ivanhoé Cambridge.

While the current trading price of $53-54 per unit is still below the activist target of $60 per unit indicated during the proxy contest, the REIT has made significant headway in terms of performance. Through to July 15, 2018, the REIT generated total unitholder returns of ~17%, outperforming the S&P/TSX Capped REIT Index, which generated returns of ~13%.

Overall, it appears that FrontFour Capital and Sandpiper Group are delivering on their plan to unlock unitholder value at Granite REIT.

CONCENTRATION ON COMPENSATION

Without significant impetus in the marketplace or at an issuer specifically, say-on-pay adoption continues to fall in Canada. Adoption is approaching an asymptote with 151 adopters amongst the S&P/TSX Composite Index.

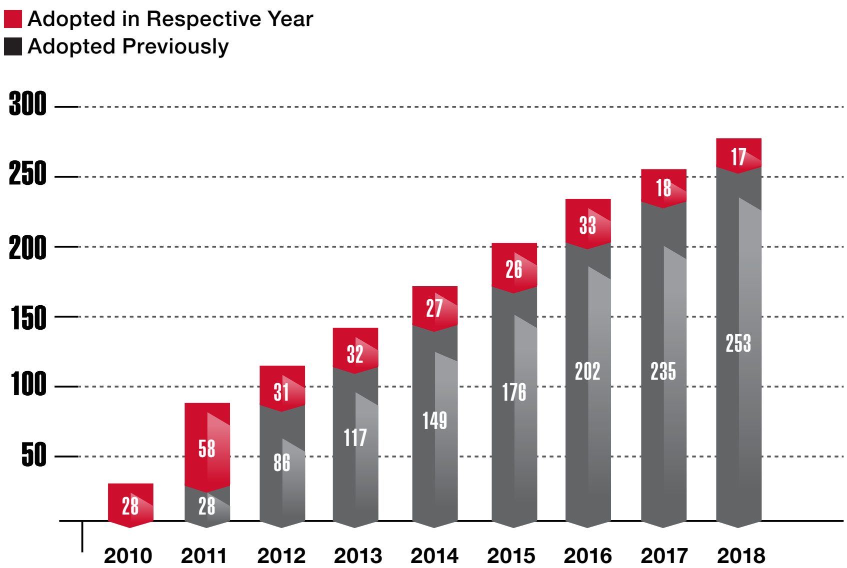
We continue to advise companies, however, to adopt say-on-pay policies both as a best practice and as an added protection for compensation committee members who might otherwise be withheld on by proxy advisors and displeased shareholders. We have also noted an increase in pension fund investors sending letters urging the boards of companies they are invested in – that do not already have say-on-pay votes – to adopt such a policy, and outlining their intention to vote against certain board committees they hold responsible. These letters are entirely policy positions and ignore the actual pay practices in place.

New Adopters in 2018

There were 17 first-time say-on-pay adopters in 2018, with 16 having disclosed their say-on-pay voting results as of the time of writing. Average support for this group was slightly above 90%, with Crew Energy earning the distinction of the new adopters with the lowest level of support at 58.73%.

Figure I

Say-on-Pay Adoption Trends of all Canadian Companies

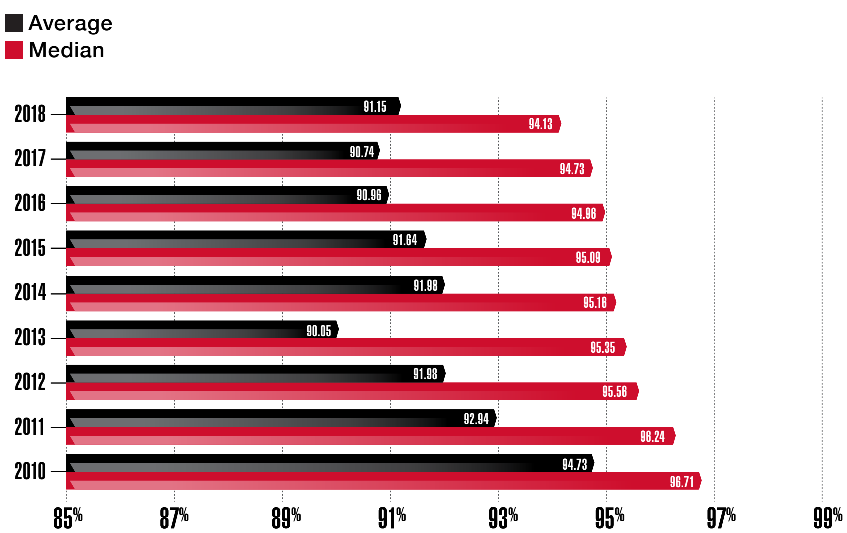


Shareholder Support Levels

Average shareholder support levels for say-on-pay throughout all industries have remained steady since 2016, hovering in the 90% to 91% range.

Figure J

Say-on-Pay Support Level Percentage



The source of data used in tables and charts in this section, unless otherwise noted, is Kingsdale Advisors, July 31, 2018.

This year, the industrials sector had the lowest average say-on-pay support level (89.48%), with Maxar Technologies earning just 47.26% support after receiving against recommendations from both major proxy advisors.

Traditionally, the materials sector has had the lowest support levels.

As with previous years, issuers in the energy and materials sectors remain the most active adopters in 2018, a total of 41 energy sector companies and 48 materials sector companies had say-on-pay votes.

Figure K

Sectoral Analysis on Say-on-Pay

Sector	2018 Average Support	# of Issuers
Telecoms	96.29%	4
Con. Staples	95.45%	6
Real Estate	94.23%	5
Utilities	93.75%	10
IT	93.39%	8
Financials	92.59%	25
Con. Discretionary	90.48%	15
Materials	90.43%	48
Health Care	89.89%	3
Energy	89.66%	41
Industrials	89.48%	20

Companies that Failed Say-on-Pay

In 2018, three Canadian-listed companies failed say-on-pay compared to four in 2017. This year's failed votes were at Maxar Technologies, IMAX, and Crescent Point Energy.

This is the first year that Maxar Technologies failed say-on-pay, with just 47.26% shareholder support; last year, the company received 71.16% support, with ISS recommending for and Glass Lewis against.

IMAX failed their say-on-pay vote for the second consecutive year, with 43.17% support after a for recommendation from ISS but an against recommendation from Glass Lewis. Last year, IMAX received just 29.98% support.

As noted previously, Crescent Point Energy represents a special case of say-on-pay failure at a contested meeting. Activist Cation Capital had actively criticized Crescent Point Energy's say-on-pay during its campaign to replace four directors. ISS ultimately recommended against Crescent Point Energy's say-on-pay while Glass Lewis supported it, leading to 38.52% support. Comparatively, Crescent Point Energy received 86.36% support last year with both ISS and Glass Lewis supporting, but failed in 2016 with just 31% support.

As noted earlier, while Crescent Point Energy failed its say-on-pay vote, the company did win its proxy fight against Cation Capital. While on the surface it may appear anomalous, we believe there are two key reasons for this. Firstly, shareholders have a higher bar for replacing directors than for voting against say-on-pay. Secondly, given the say-on-pay history at Crescent Point Energy, this may be a case of shareholder fatigue, with shareholders expressing their displeasure of the board's performance via the non-binding say-on-pay vote versus risking appointing questionable activist nominees to the board.

Three companies failed say-on-pay in 2018

Maxar Technologies	IMAX	Crescent Point Energy
47.26%	43.17%	38.52%

Companies that Failed in 2017 – Where Are They Now?

TransAlta received 89.01% support for say-on-pay at its 2018 annual general meeting, having been supported by both ISS and Glass Lewis, a reversal from the previous year when both proxy advisors recommended that shareholders vote against. Based on TransAlta's 2018 information circular, "as a result of last year's voting result, the Board and HRC undertook a rigorous review of the compensation arrangements and undertook extensive shareholder engagement." TransAlta also disclosed that it had engaged with the proxy advisory firms in October 2017. Collectively, TransAlta engaged shareholders representing 46% of the shares outstanding and met with 11 shareholders representing 35% of the shares outstanding. TransAlta also made several structural changes to their compensation programs, including increasing their Performance Share Unit (PSU) percentage by 5% (thereby decreasing reliance on stock options) and forgoing discretionary increases in payouts.

Eldorado Gold received 90.74% support at its 2018 annual general meeting for say-on-pay, having been supported by both ISS and Glass Lewis. (In 2017, ISS recommended against say-on-pay while Glass Lewis recommended support.) Based on Eldorado's 2018 information circular, "In 2017, in addition to executing our regular annual and charter appointed duties, the Compensation Committee along with management communicated with our Shareholders on executive compensation matters." In April 2017, Eldorado Gold "reached out to the Company's key Shareholders by phone and email to provide information on our compensation practices and solicit feedback ahead of Eldorado's annual general meeting." Again, in November 2017, "Management met with and solicited feedback from the Company's key Shareholders (i.e. those representing 40% of our Shareholder base at the time), on business strategy and executive compensation." The key change in Eldorado Gold's pay structure was a new CEO with lower target short- and long-term incentive pay. Additionally, weightings of PSUs were increased and the company announced that, going forward, annual bonuses will only be linked to measurable corporate performance.

IMAX received 43.17% support at its 2018 annual general meeting for say-on-pay, having received support from ISS but not Glass Lewis, whereas last year both ISS and Glass Lewis recommended against the say-on-pay. Based on IMAX's 2018 information circular, "We have made continuing efforts over the past several years to better understand and address shareholders' concerns regarding our compensation program. On an annual basis, we engage with shareholders representing more than half of our outstanding shares and gather feedback on, among other things, our executive compensation program."

Primero Mining was acquired by First Majestic Silver in May 2018 and, as such, no say-on-pay vote was held.

Based on these examples, it is evident that proxy advisor support, shareholder engagement, understanding, and goodwill represent key tools for companies facing say-on-pay issues.

Companies with Less Than 75% Support

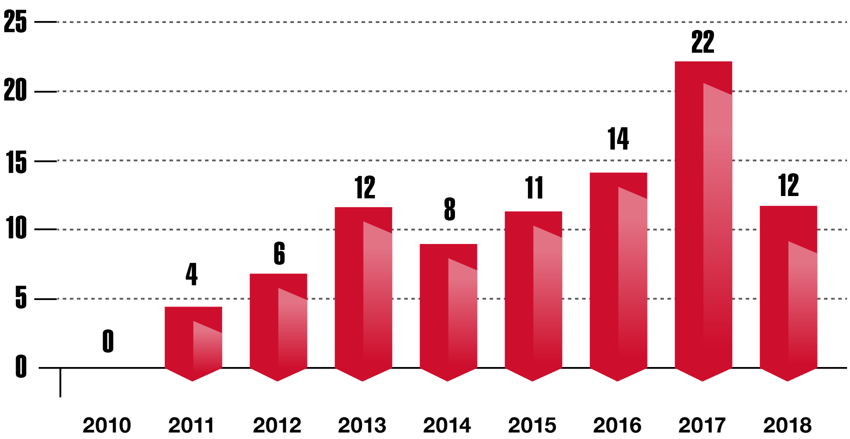
Say-on-pay adopters are faring better than in previous years. This year, the number of companies that received less than 75% support for their say-on-pay resolutions dropped to 12 from 22 in 2017.

We attribute much of this decline to the ramping up of shareholder engagement efforts by companies and a general increase in awareness among compensation committees of the impact of ISS' and Glass Lewis' recommendations and the process involved in making them.

Notably, based on our tracking, ISS only recommended against say-on-pay at eight companies this year compared to 18 companies this time last year, a record high. As for Glass Lewis, it recommended against say-on-pay for at least 18 companies compared to 12 in 2017, representing a high watermark.

Figure L

Companies with Say-on-Pay Votes Receiving Less Than 75% Support



Of the 12 companies receiving less than 75% support, one-third received both ISS and Glass Lewis support. It appears that, while ISS remains the far more influential proxy advisor, shareholders are more willing to go against proxy advisor recommendations when it comes to compensation issues.

Innovative Design: Tesla Revolution and Performance-Based Mega-Grants

It seems that Tesla is not only an innovator when it comes to cars but also an innovator when it comes to compensation. Earlier this year, Tesla introduced a never-before-seen one-time mega-stock option grant to its founder and CEO, Mr. Elon Musk, and put the grant up for binding shareholder approval at a special meeting held just for the purpose of approving the grant.

The present value of Musk's 10-year stock option grant, vesting in 12 tranches based on aspirational performance metrics, totals a whopping US$2.6 billion, with the future value that could be realized reaching US$55.8 billion. Beyond the massive face value of the grant, there were several unique features to this innovative compensation scheme:

- The package demonstrates the pay-for-performance doctrine in its purest form with an all-or-nothing design. The vesting conditions of each tranche are comprised of one market capitalization milestone (at increments of US$50 billion up to US$650 billion after first reaching US$100 billion from the current US$55 billion) and one operating milestone (out of eight topline milestones and eight bottom-line milestones: revenue from US$20 billion to US$175 billion; adjusted EBITDA from US$1.5 billion to US$14 billion).
- It is a long-term package that lasts 10 years but has no quarterly or annual targets. The milestone can be reached at any time within the 10 years. Multiple tranches can vest at once. In a world where short-termism has gained popularity, this feature really stands out.

- Rather than traditional figures like total shareholder return and real profitability, the scheme focuses on growing market capitalization and topline revenue.

Tesla engaged with 15 of its largest institutional shareholders over six months while designing this package. Ultimately, both ISS and Glass Lewis recommended that shareholders vote against the pay package. Despite this, approximately 80% of shareholders supported the resolution. Clearly, as the Tesla case proves, shareholders can and will cast their votes according to their own analysis and opinion, ignoring ISS and Glass Lewis recommendations.

Canada has yet to see such a mega-grant to its top executives followed by a special meeting to approve a compensation item on a binding basis. One comparable case is BlackBerry CEO Mr. John Chen's contract extension this year, whereby his pay package included time-based and performance-based equity grants and an incentive cash award with total pay opportunity equal to US$253 million.

While BlackBerry did not put the pay package to a special binding vote, Chen's pay package was voted on as part of BlackBerry's 2018 say-on-pay vote. Interestingly, ISS supported the compensation arrangement, citing stellar FY18 performance and the fact that the new contract extension includes the introduction of PSUs. Glass Lewis, on the other hand, recommended that shareholders vote against, citing concerns related to the quantum and structure of the award. In particular, Glass Lewis questioned the reliance on share price hurdles as a performance metric for the PSUs where share prices can also benefit (or suffer) from transitory factors that aren't necessarily under management's control. Nevertheless, shareholders supported BlackBerry's 2018 say-on-pay with 90.6% support.

For Canadian companies, the Tesla compensation program could be an example to follow for issuers wanting to get around ISS and Glass Lewis against recommendations. A specific compensation item, once approved by shareholders, would likely not be criticized by ISS or Glass Lewis in the future, given that shareholders have already clearly given their blessing. But a move like this also comes with increased risk to the compensation committee; careful planning and engagement are required to sell these plans to shareholders.

And, while on the topic of Tesla, we would be remiss if we did not offer a caution about the use of Twitter. As Musk has learned after his tweet about taking Tesla private, along with his numerous other tweets over the years, tweeting can have a big impact on corporate reputation and a company's share price. Will Musk tweet his way away from hitting his milestone targets?

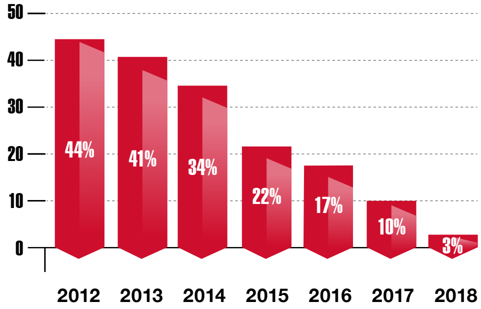
KEY GOVERNANCE DEVELOPMENTS

Board Diversity

In some ways, 2018 is set to be the year of gender diversity on Canadian boards. As of the beginning of 2018, ISS will recommend that shareholders of S&P/TSX Composite Index companies withhold votes from the chair of the nominating committee if the company has not disclosed a formal and robust written gender diversity policy, ***and*** if there are no female directors on the board. All TSX 60 constituents came to their 2018 annual general meetings with at least one woman on board and only 3% of the S&P/TSX Composite Index companies have no women on board. According to a study conducted by the Canadian Securities Administrators published on October 5, 2017, 39% of TSX-listed companies still have no women on their boards. ISS will extend this policy to the broader TSX mainboard in 2019.

Figure M

Percentage of S&P/TSX Composite with No Women on Board



Source: ISS Analytics

Similarly, Glass Lewis will generally recommend that shareholders vote against the chair of the nominating committee for companies that have no female directors ***or*** have not adopted a formal written gender diversity policy effective in 2019.

Based on a recent publication by the Canadian Gender and Good Governance Alliance, women hold approximately 14% of all board seats on the TSX and only 26% of open board positions are filled by women candidates.

With the major proxy advisors' policies kicking in during the 2019 proxy season, we have seen and expect to continue to see a ramp-up of gender diversity initiatives at TSX-listed companies.

The source of data used in tables and charts in this section, unless otherwise noted, is Kingsdale Advisors, July 31, 2018.

Diversity Beyond Gender

While gender diversity remains a hot topic in the governance world, other forms of diversity are also coming into play. ISS' less influential social advisory arm recently updated its guidelines to include a policy related to broader diversity. Beginning in 2018, ISS' Social Advisory Services has recommended that shareholders withhold votes from nominating committee members if the board lacks at least one woman and one minority, and the board is not at least 30% diverse (on a racial and gender basis).

This move certifies the importance of diversity beyond gender and we expect shareholders to follow suit in years to come. Companies are advised to bolster their disclosure in cases of racial diversity to further make it easier for shareholders to get the information they need to make the correct voting decision. For example, a simple addition to the director biography regarding racial and other forms of diversity, where applicable, could go a long way. We have learned that directors' photos aren't always enough to identify racial diversity as photos can be easily misinterpreted.

Directors Triggering Majority Voting Policies

The application of majority voting policies remains a rare occurrence in Canada. Last year, only one director received less than 50% support, thereby triggering the majority voting policy, while this year, majority voting policies were triggered for three directors at two companies.

In the first case, at Partners REIT's 2018 annual general meeting, Messrs. Simon Nyilassy and Moray Tawse received 44.2% and 45.4% support, respectively, despite both nominees receiving ISS and Glass Lewis support. Mr. Nyilassy had been a trustee since 2015 while Mr. Tawse was a first-time nominee, holding 20.7% of the REIT's outstanding units. Mr. Tawse was also a significant shareholder in First National Financial, which had provided various mortgages, mortgage brokerage arrangements, and a line of credit to Partners REIT. In these cases, we believe that unitholder discontent motivated opposition to these two trustee nominees and manifested itself through a behind-the-scenes withhold campaign.

Both nominees offered their resignation shortly after the meeting. Generally, an issuer's governance or nominating committee would deliberate the resignation within 90 days prior to making its decision once majority voting policies are triggered. In this case, however, Partners REIT confirmed that both resignations were accepted concurrently with the filing of the report of voting results.

In the second case, Mr. Ruilin Zhang, director of Journey Energy, received 39.7% support at the company's 2018 annual general meeting. While Glass Lewis recommended that shareholders withhold votes from him, ISS recommended that shareholders support his election. Despite ISS' support, Mr. Zhang received less than 50% support.

One day after the May 23, 2018 annual general meeting, the company announced in a press release that Mr. Zhang had resigned pursuant to the majority voting policy of the company and that its Governance and Compensation Committee would consider the resignation and make a recommendation as to whether or not they should accept it within 90 days. On June 18, 2018, Journey Energy announced that the company had accepted Mr. Zhang's resignation.

Virtual Annual General Meetings

The adoption of virtual meetings continues to rise in the U.S. while, in Canada, we've seen a failure to launch.

In the U.S., according to Broadridge Financial, which recently facilitated its 1,000th virtual meeting, the first six months of 2018 saw public companies host 212 virtual meetings in comparison to 180 in 2017 over the same period. Broadridge estimates that by year-end, we'll have seen 300 virtual meetings, representing a 27% increase year over year.

In contrast, year two of virtual meetings in Canada has not yielded a significant growth in adoption. So far in 2018, only five companies have hosted virtual meetings,

MAJOR INSTITUTIONAL SHAREHOLDERS AND PENSION FUNDS HAVE ALREADY INCORPORATED GENDER DIVERSITY AS PART OF THEIR PROXY VOTING GUIDELINES. BELOW ARE SELECT POLICIES FROM MAJOR CANADIAN FUNDS:

- **BCI:**

"BCI will vote against the chair of the nomination/governance committee if a board lacks adequate female representation unless there is a legitimate rationale or plan to address this gap going forward."

- **RBC GAM:**

"We will generally support proposals that call for enhanced disclosure or reporting requirements regarding board diversity policies and procedures. We will generally support proposals to adopt non-binding guidelines for female or other minority representation on the board. We will review proposals to adopt binding quotas or targets for female or other minority representation on the board on a case by case basis. If a company's board has no women directors and does not disclose its policy on diversity, or discloses a diversity policy that is inadequate, we may vote against directors who sit on the nominating and corporate governance committees of the board. An adequate policy should include: (i) A commitment to increase board gender diversity; (ii) Measurable goals or targets to increase board gender diversity within a reasonable period of time. Consideration will be given to a board's approach to gender diversity in executive officer positions and any related goals, targets, programs or processes for advancing women in executive roles. We expect issuers to disclose progress on reaching board gender diversity targets and the strategies or plans employed to achieve them."

- **AIMCo:**

"Generally, vote for shareholder proposals that request companies to comply with applicable local market regulations for board diversity, such as disclosure of the processes to nominate women to their board. AIMCo may, subject to discretion and extenuating circumstances, vote against or withhold our vote from the chair of the nominating committee in developed country markets where the issuer exhibits low levels of board gender diversity, such as where there have been no women on the board for the last 2 or more years, with no stated targets to achieve gender diversity."

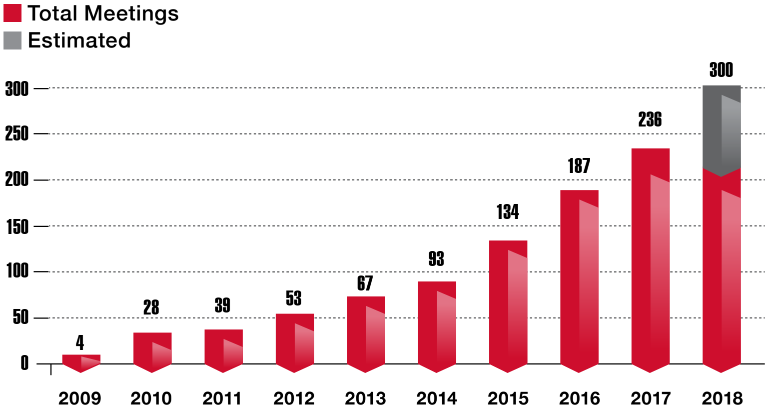
And institutional investors aren't alone. Activist Mr. Bill Ackman of Pershing Square said in April he was wanting to run a proxy contest with an all-female, diverse, ethnic slate, noting he was sure it would win hands-down.

with four of those hosting a hybrid virtual/physical location meeting, an approach that affords issuers the opportunity to test the waters.

The platform of choice for Canadian companies is Lumi Global, which was used for all five virtual meetings in Canada. Meanwhile, Broadridge, which made its virtual meeting services available in Canada for the first time this year, has yet to gain any traction. It should be noted that the Lumi platform has been used as an add-on to existing material distribution and voting channels, focusing on just the shareholders' meeting. This may explain its appeal for hybrid meeting adopters. The Broadridge model, on the other hand, is an end-to-end solution of material distribution, voting channels, and annual general meeting platform. Given the more fundamental offering, Broadridge will likely appeal to issuers looking to make strategic changes rather than bolt-on capabilities.

Figure N

Virtual Meetings Hosted in the U.S.



Proxy Access One Year Later

Since the 2017 proxy season that saw the emergence of proxy access in Canada and the prediction of follow-on cases, not a lot has happened.

Following the shareholder proposals submitted at the 2017 annual general meetings of the Toronto-Dominion Bank and Royal Bank of Canada by Mr. Lowell Weir, all the tier one Canadian banks, along with two major insurers, have voluntarily adopted proxy access in policy form, which doesn't require shareholder approval.

This year, Mr. Weir went on to submit follow-up shareholder proposals at TD and RBC's 2018 annual general meetings calling for the following:

- *"The Proxy Access Policy implemented by the conflicted Bank Directors be cancelled immediately."*
- *"The Proxy Access By-law be implemented immediately by Bank Directors."*
- *"The Chairman of the Bank Board of Directors immediately resign."*
- *"A complete change in the governance committee directors be implemented over the next twelve months."*
- *"Any Director or Officer refusing to act in accordance with this Resolution shall immediately submit their resignation from the Bank."*

Ultimately, and unsurprisingly given the radical nature of the proposal, the TD 2018 shareholder proposal received only 1.4% support, with both ISS and Glass Lewis recommending against it, while the proposal at RBC was withdrawn.

It is interesting to note that Kingsdale privately tracked one case where an activist submitted a proxy access shareholder proposal to a company pursuant to a campaign to nominate directors. However, ultimately, the shareholder proposal was pulled when the activist campaign was settled without a public fight.

FOLLOWING OUR LAST REPORT, THE CANADIAN COALITION FOR GOOD GOVERNANCE (CCGG) RELEASED THEIR PROXY ACCESS POLICY IN NOVEMBER 2017. THE CCGG VERSION OF PROXY ACCESS FOLLOWS THE TERMS BELOW:

- **A shareholder or group of shareholders must hold an aggregate economic and voting interest of at least 3% of the outstanding shares**
- **The 3% minimum threshold must have been held for at least 3 years**
- **The number of directors to be nominated by shareholders using the proxy access mechanism cannot exceed the greater of 2 or 20% of the board**
- **Nominating shareholders must represent that they are not seeking control and that their economic ownership interest is at least equal to 3% of the issuer's outstanding voting shares**
- **Disclosure about shareholder nominees should be set out fairly in the company's proxy circular, including being located in the same section of the proxy circular with the same prominence and on essentially the same terms as disclosure about the company's nominees, along with the use of a fair "universal proxy" form**
- **Shareholders nominating directors should be able to use the company's proxy circular to solicit support (i.e. they should not be required to deliver a dissident circular)**
- **Shareholders must continue to hold the prescribed percentage of shares up to the time of the meeting at which the shareholder-nominees are proposed for election**
- **Proxy access be adopted in the form of a by-law rather than a board policy**

Despite the developments with the CCGG model policy, no companies beyond the tier one Canadian banks and two large insurers have voluntarily adopted proxy access.

Shareholder Proposal Spotlight

Based on statistics tracked by Kingsdale and the Shareholder Association for Research & Education (SHARE), 50 shareholder proposals have been submitted at 27 different Canadian companies so far in 2018. Of the 50 proposals, 22 were withdrawn before going to a vote, one is still pending, and 26 failed, averaging support of only 14.09%. One shareholder proposal did pass – the TransCanada proposal requesting a report on climate change – after being endorsed by management and receiving 99.10% support.

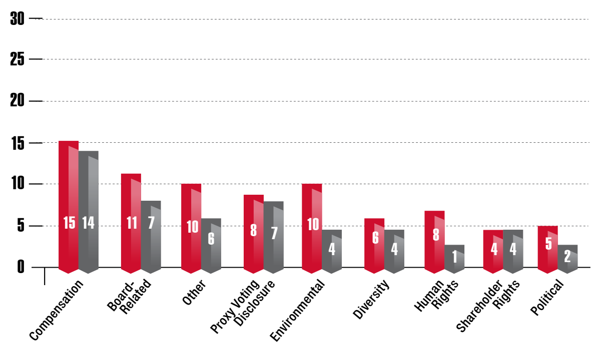
Comparatively, in 2017, 77 shareholder proposals were submitted at 33 different Canadian companies. Of the 77 proposals, 28 were withdrawn before going to the vote. Of the 49 shareholder proposals that did advance to a shareholder vote, 46 failed. Overall, shareholder proposals averaged support of 16.26%.

The shareholder proposals that passed were at Trans A.T. and Bombardier (calling for the disclosure of voting results in numbers and percentages) and at TD Bank (calling for the adoption of a proxy access by-law). We note that both proposals at Trans A.T. and Bombardier were endorsed by management, leading to greater than 99% support for the proposals, while management of TD Bank opposed the proposal, leading to 52.2% support.

Figure O

2017 Number of Proposals by Type of Shareholder Proposal

Proposals (incl. withdrawn)
Proposals Voted



2017 Average Support Level by Type of Shareholder Proposal

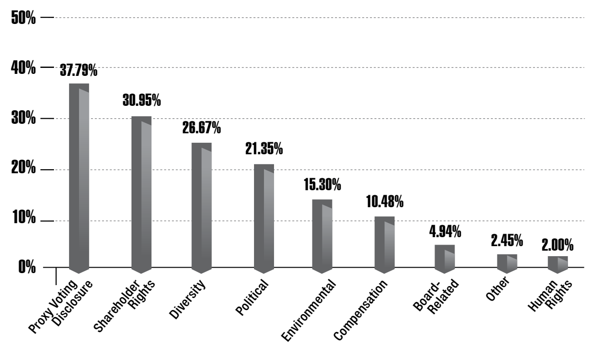
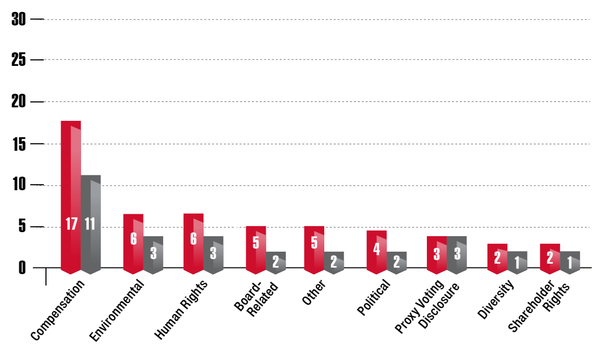


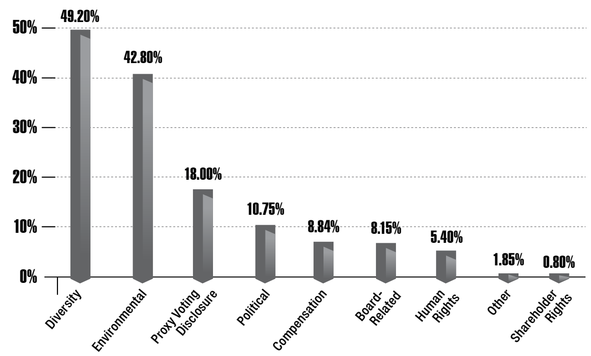
Figure P

2018 Number of Proposals by Type of Shareholder Proposal

Proposals (including withdrawn)
Proposals Voted



2018 Average Support Level by Type of Shareholder Proposal



In 2018, compensation-related proposals remained the most popular type of shareholder proposal, with 17 submitted in 2018 and 11 of those voted on vs. 15 submitted in 2017 and 14 voted on. The *Mouvement d'éducation et de défense des actionnaires* (MÉDAC) was the most prolific filer, with 29 proposals at 14 different companies. MÉDAC's proposals cover a wide range of different topics, inclusive of board-related issues, compensation, proxy voting disclosure, and environment-related proposals.

The Fonds de solidarité des travailleurs du Québec (FTQ) was the second most frequent filer, with four proposals filed at four unique companies focusing on political lobbying, human rights, diversity, and environment-related issues.

Tied for third place are the B.C. Government and Service Employees' Union General Fund, individual shareholder Mr. Lowell Weir, and OceanRock Meritas Jantzi Social Index Fund, each having filed three proposals. The B.C. Government and Service Employees' Union General Fund focused on human rights, board-related, and environmental issues; Mr. Lowell Weir focused on shareholder rights related to the proxy access proposal filed in the previous year; and OceanRock Meritas Jantzi Social Index Fund focused on political lobbying.

ESG SPOTLIGHT

In previous years, we've forecasted the rise of environmental, social, and governance (ESG) concerns and subsequent proposals from shareholders. This year, we can declare ESG has arrived with a record number of majority-supported proposals in the U.S. and a little help from activist funds. Canadian companies that have followed international trends and proposals at larger companies have been well-served in their preparedness.

Over the last few years, ESG's growing prominence in the investment sector has been nothing short of remarkable. ESG investing is now estimated at over US$20 trillion AUM, with ESG being integrated into portfolios at a growth rate of 17% a year.[1]

Credit agencies have also taken note, with Standard & Poor's and Moody's publicly acknowledging climate change is a major risk not currently factored into their ratings. Moody's has gone a step further, warning U.S. coastal cities they need to show evidence of preparing for climate change impacts or face a downgrade on their bonds. Now environmental issues have teeth. A downgrade to a city like Los Angeles would have a major effect on the cost of borrowing and impact their ability to fund city projects. Similarly, small island states could have their sovereign debt downgraded, limiting their development and making them more reliant on aid.

Evolving Shareholder Attitudes

Increasingly, investors around the world are taking the view that an issuer's environmental and social activities will impact its financial returns and long-term sustainability.

At the root of this new investment philosophy is an increased awareness of topics such as climate change, wealth gaps, and gender inequality, along with a belief that these are important when making investment decisions – either because integration of these factors can be used as part of a risk mitigation screening process when evaluating companies or because investors are increasingly adopting the belief that what you invest in is equally important to the returns you see. In Canada, this is being fuelled by dramatic demographic shifts.

First, millennials, who account for a larger proportion of issuers' shareholder base every year, are 65% more likely than their parents to examine a company's environmental and social record when making investment decisions, according to a recent study by the Responsible Investment Association (RIA).

Second, studies have shown that women are more sympathetic to ESG issues than their male counterparts. Consequently, as the share of private wealth controlled by women doubles to more than $2.7 trillion by 2024, Canadian companies can expect increased pressure to pursue environmental and social initiatives as well as equal representation in the boardroom.

Investors in some industries have tuned in more than others as well. Take Canada's mining sector for example. It is an attractive asset class globally but is highly susceptible to climate change. Much of Canada's northern mining relies on winter supply via ice roads and summer access over permafrost roads. Shorter, mild winters or loss of permafrost would lead to supply shortages, massive capital outlays, or inability to access mine sites at all. Shareholders want to see some indication of how these risks will be managed.

Institutional investors have realized that management teams that show they are able to grapple with the multiple non-aligned issues and stakeholders on ESG show adaptive management skills correlated with handling complex business and strategy issues – the kind of skills that underpin adaptation for long-term performance.

U.S. Trends

This mainstream investor interest in environmental and social issues has certainly manifested itself in the 2018 proxy season, especially south of the border, where it has received record support.

According to ISS Voting Analytics, there were 87 proposals related to environmental and social issues in 2017. Year to date in 2018 there have been 63. At this point, it is uncertain whether the number of proposals by the end of the year will surpass last year's level.

However, while in 2017 only four environmental and social shareholder proposals passed, year to date in 2018 a record number of eight environmental and social proposals have passed.

Figure Q

Year	Company Name	Proposal	Meeting Date	Support Level
2018	Sturm, Ruger & Company, Inc.	Report on Gun Violence	May 09, 18	68.0%
2018	Depomed, Inc.	Report on Governance Measures Implemented Related to Opioids	May 08, 18	62.3%
2018	Kinder Morgan, Inc.	Report on Sustainability	May 09, 18	60.4%
2018	Kinder Morgan, Inc.	Assess Portfolio Impacts of Policies to Meet 2 Degree Scenario	May 09, 18	59.7%
2018	The Middleby Corporation	Report on Sustainability, Including GHG Goals	May 08, 18	57.2%
2018	Genesee & Wyoming Inc.	Adopt GHG Emissions Reduction Goals	May 23, 18	54.3%
2018	Anadarko Petroleum Corporation	Assess Portfolio Impacts of Policies to Meet 2 Degree Scenario	May 15, 18	52.5%
2018	Ameren Corporation	Report on Coal Combustion Residual and Water Impacts	May 03, 18	51.7%

Year	Company Name	Proposal	Meeting Date	Support Level
2017	Occidental Petroleum Corporation	Assess Portfolio Impacts of Policies to Meet 2 Degree Scenario	May 12, 17	65.7%
2017	Exxon Mobil Corporation	Report on Climate Change Policies	May 31, 17	62.1%
2017	PPL Corporation	Assess Portfolio Impacts of Policies to Meet 2 Degree Scenario	May 17, 17	56.8%
2017	Pioneer Natural Resources Company	Report on Annual Sustainability	May 18, 17	50.6%

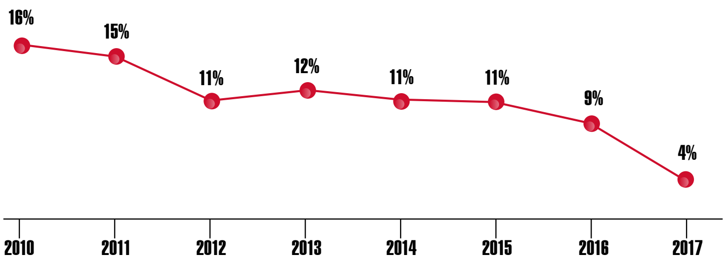
(Source: ISS Voting Analytics)

[1] "The Remarkable Rise Of ESG", George Kell. Forbes.com, July 11, 2018

Two of the more high-profile majority votes were at Kinder Morgan and Anadarko Petroleum. Shareholders at both companies passed resolutions requiring the issuers to report on how they're preparing for a 2°C limit on global warming pursuant to the 2015 Paris Accord. All but two of the majority votes were environmental resolutions, with the others related to gun safety and opioid abuse.

Figure R

Percentage of Abstain Votes on ESG Proposals



Source: ISS Voting Analytics January 2018

Along with the increase in majority-supported proposals, we're seeing a concurrent drop in the rate of abstain votes on ESG proposals. This illustrates that investors are increasingly taking a position on ESG proposals rather than viewing them as non-essential segments of the voting program.

Institutional Investors Becoming More Vocal About ESG

Part of what is driving the decrease in abstain votes is that large institutional investors are becoming more involved in supporting and promoting ESG-related issues and subsequent shareholder proposals:

- In January, BlackRock Chairman and CEO, Mr. Larry Fink, issued an open letter to CEOs of companies in its portfolio urging them to develop long-term strategies in the context of non-financial metrics. BlackRock backed up the letter with a plan to double the size of its investment stewardship team and launched a suite of open-ended ESG Emerging Market Debt funds.

- In February, Hermes Equity Ownership Services announced that it will seek to support long-term sustainable growth through a comprehensive ESG engagement policy.

- In June, Fidelity Investments announced a new sustainability bond index fund.

According to a 2018 State Street survey report, the impetus for institutional investors to support ESG comes from the recognition that these issues are material to long-term financial outcomes. Specifically, the report notes that "developments such as the United Nation's Principles for Responsible Investment are helping investors to see ESG factors in terms of both opportunity and risk."

ESG IN THE CROSSHAIRS

"We also see many governments failing to prepare for the future, on issues ranging from retirement and infrastructure to automation and worker retraining. As a result, society increasingly is turning to the private sector and asking that companies respond to broader societal challenges. Indeed, the public expectations of your company have never been greater. Society is demanding that companies, both public and private, serve a social purpose. To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate."

Mr. Larry Fink,
BlackRock Chairman and CEO

"We are an asset manager with a difference. We believe that, while our primary purpose is to help savers and beneficiaries by providing world-class active investment management and stewardship services, our role goes further. We believe we have a duty to deliver holistic returns – outcomes for our clients that go far beyond the financial – and consider the impact our decisions have on society, the environment and the wider world. Our goal is to help people invest better, retire better and create a better society for all."

Hermes Equity Ownership

"We're providing more opportunities for investors to advance specific causes and align their personal principles with their investment objectives."

Colby Penzone,
Senior Vice President for
Fidelity's Investment Product Group

Activists Jump on the ESG Bandwagon

This year, we saw activists start embracing ESG. JANA Partners, in conjunction with the California State Teacher's Retirement System (CalSTRS), pressured Apple to restrict children's access to iPhones and develop a study on the effects of the device on teenagers, declaring "Addressing this issue now will enhance long-term value for all shareholders." They've also hired an ESG portfolio manager and announced plans to launch the JANA Impact Capital Fund that will invest in companies that "are good bets but could do better for the world."

Similarly, Blue Harbour Group said that social and environmental considerations will carry more weight with regard to how it will decide where to invest its US$3 billion in assets, and Mr. Bill Ackman of Pershing Square mused about running a proxy contest with an all-female board.

So why have activists, who are often characterized as short-term actors focused exclusively on the bottom line, become so enamoured of ESG?

The simple answer is that, like many retail and institutional investors, activists have recognized the link between ESG and long-term sustainable growth as well as overall positive impact on a company's brand. The more complicated and perhaps cynical answer is that activists are publicly supportive of ESG initiatives as a means to court major institutional investors who have championed ESG investing.

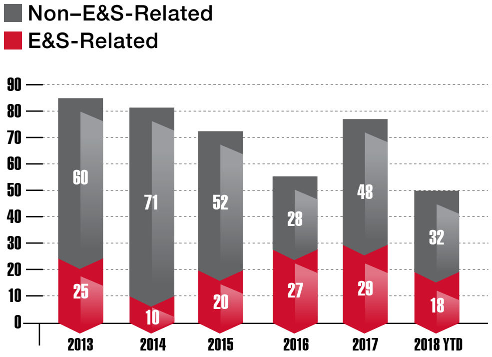
Whatever the reason, the key takeaway for issuers is that activists have now joined in and are supporting and promoting ESG proposals, presenting a new dynamic moving forward.

What's Happening in Canada

Despite a smaller market and a slightly reduced net volume of ESG proposals (29 in 2017 vs. 18 so far in 2018), Canada has also shown a strong receptivity to ESG concerns and proposals. The RIA reported that, as of 2018, responsible investing represents 38% of the Canadian investment industry. Additionally, according to a survey conducted by RBC Global Asset Management, two-thirds of institutional investors currently consider ESG factors when undertaking investment or voting. Not surprisingly, given Canada's high volume of corporations operating in the energy and resource sectors, there is a proportionately higher degree of exposure to environmental proposals.

Figure S

Number of Shareholder Proposals Submitted in Canada



Note: E&S proposals include environmental, human rights, political and diversity-related proposals. Non-E&S proposals are all others.

Source: Kingsdale and SHARE (July 31, 2018)

A Closer Look at 2018 in Canada

Based on Kingsdale's analysis, in 2018, environmental and diversity-related shareholder proposals received the highest average support levels, with one environment-related shareholder proposal seeking a report on climate change filed at TransCanada passing with 99.10% – which is not surprising given that management endorsed the proposal. This endorsement skews the average support level overall, but if it is excluded as an outlier, the average support level for the three environment-related proposals that went to a vote would be just 14.65%.

Figure T

2018

Proposal Type	# Proposals (incl. withdrawn)	# Proposals Voted	Average Support Level
Diversity	2	1	49.20%
Environmental	6	3	42.80%
Proxy Voting Disclosure	3	3	18.00%
Political	4	2	10.75%
Compensation	17	11	8.84%
Board-Related	5	2	8.15%
Human Rights	6	3	5.40%
Other	5	2	1.85%
Shareholder Rights	2	1	0.80%

2017

Proposal Type	# Proposals (incl. withdrawn)	# Proposals Voted	Average Support Level
Proxy Voting Disclosure	8	7	37.79%
Shareholder Rights	4	4	30.95%
Diversity	6	4	26.67%
Political	5	2	21.35%
Environmental	10	4	15.30%
Compensation	15	14	10.48%
Board-Related	11	7	4.94%
Other	10	6	2.45%
Human Rights	8	1	2.00%

While in the U.S., companies can seek no-action relief from the Securities and Exchange Commission, Canadian companies are not afforded the same mechanisms to strike down shareholder proposals and not include them in the information circular. As such, companies may often find themselves being engaged by shareholders or pension funds on ESG and other issues prior to the filing of shareholder proposals.

In our experience, if environmental and social shareholder proposals are received, issuers can engage the filer to understand their exact desires. At times, if additional disclosure is requested and the information is available internally, it may be relatively easy to appease the filer by providing such information. For example, while a total of 18 environmental and social-related proposals were submitted to companies in 2018, half of them were withdrawn. While the exact reasoning as to why proposals were withdrawn is not always disclosed publicly, based on our experience, we see that in most cases companies had engaged the filer to understand the exact concerns and to address them.

Figure U

Passing Shareholder Proposals in 2017 and 2018

Company	AGM Date	Proposal	Filer	Support Level	MGMT Recommendation	ISS Recommendation
Trans A.T. Inc.	March 6, 2017	Approve Disclosure of Voting Results as Numbers and Percentages	Mouvement d'éducation et de défense des actionnaires (MÉDAC)	99%	FOR	FOR
Toronto-Dominion Bank	March 20, 2017	Adopt Proxy Access Bylaw	Mr. Lowell Weir	52.20%	AGAINST	FOR
Bombardier Inc.	May 11, 2017	Disclosure of Voting Results as Numbers and Not Only as Percentage	Mouvement d'éducation et de défense des actionnaires (MÉDAC)	99.50%	FOR	FOR
TransCanada Corporation	April 27, 2018	Report on Climate Change	Two Québec religious orders	99.10%	FOR	FOR

Kingsdale's Take

ESG is now part of the investing mainstream. While this can pose several challenges for issuers as they seek to understand how their ESG profile will be understood and benchmarked by investors, there are several proactive measures boards can take to remain ahead of the ESG curve.

Develop your own ESG policies. A proactive approach can help reduce the probability of issuers receiving shareholder proposals that may be popular but do not align with their strategy. In developing ESG policies, issuers should be aware of what proposals are being received by peers and with what levels of support, and conduct an internal ESG SWOT analysis.

Enhance disclosure. Retail and institutional shareholders alike are seeking greater transparency and disclosure regarding issuer preparedness on environmental and social issues. We advise clients to develop a corporate responsibility report, updated bi-annually and available for shareholders.

Understand the ESG policies of your shareholders. We recommend that issuers be informed about the ESG voting policies of their shareholders and ensure that their concerns are addressed in the corporate responsibility report or as part of ongoing outreach. We also recommend that companies include proactive discussion on this topic during regular shareholder meetings to ensure they are not left in the dark about an investor's view.

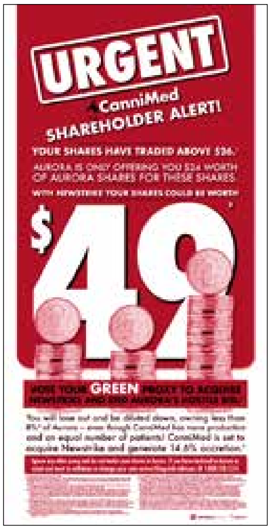
Ensure your board has environmental and social risk expertise. Issuers need to ensure that their board composition has the expertise required to address environmental and social issues, in addition to allocating the responsibility for managing this risk to a specific committee. Companies could also consider the use of an advisory board or having expert advisors present to join relevant committees.

If these steps fail and shareholder proposals are brought forward, companies can negotiate with the shareholder to find a mutually agreeable path forward that often includes commitments from the company. Unlike an activist attack, we do not recommend a company openly engage in a campaign against a shareholder proposal in the ESG space, as many will see such proposals as wholesome as mother's milk.

POT SHOTS: WHAT CANNIMED'S POISON PILL DEFENCE AGAINST AURORA MEANS

It's a pivotal time in the Canadian cannabis industry as companies seek to position themselves as players in the new recreational market. A flurry of recent deals has led to the major companies increasing their market position, ramping up production capacity, and strengthening their balance sheets.

November 2017 marked the first hostile bid in the cannabis industry and only the eighth under Canada's new hostile bid regime. It was, however, the first test of a tactical rights plan – or poison pill – under the new rules.



Kingsdale designed a national advertising campaign to galvanize CanniMed shareholders and force Aurora to increase its bid. A similar tactic was used by Canadian Oil Sands in its hostile bid defence against Suncor.

The Bid Comes In

On November 13, 2017, Aurora Cannabis submitted a proposal to CanniMed Therapeutics Inc.'s board of directors to purchase all of the issued and outstanding common shares of CanniMed for consideration, consisting of common shares of Aurora valued at $24.00 per CanniMed share, subject to variation as Aurora's share price changed.

CanniMed rejected the offer and, on November 17, announced a friendly acquisition agreement with Newstrike Resources whereby Newstrike shareholders would receive 33 CanniMed shares per 1,000 Newstrike shares. The Newstrike offer also included a $9.5 million cancellation fee clause.

Aurora called the Newstrike deal "oppressive to CanniMed shareholders and to Aurora's offer" and on November 27 launched its formal takeover bid with support from three of CanniMed's largest shareholders, at the time representing 38% of CanniMed shares.

In response, CanniMed adopted a shareholder rights plan – notably a day before Aurora could start making purchases under the 5% exemption. The poison pill tactic was something many, including regulators, considered unnecessary under the new takeover rules except to prevent creeping bids and private agreements. However, the 38% locked-up plus the ability to make additional purchases was clearly going to make finding a superior proposal difficult.

Having been part of CanniMed's advisory team, the strategy was not to implement a rights plan the regulators would uphold, which was acknowledged to be a challenge, but to buy time to protect the Newstrike deal.

Adopting a rights plan would not only stop Aurora from relying on the 5% exemption to buy more shares in the open market, which would create a blocking position for any other transaction and from entering into additional lock-up agreements with shareholders, but would also provide CanniMed with more time to get additional news and deals into the market, and advance its transaction with the little-known Newstrike. If the Newstrike deal was supported, Aurora had said it would abandon its bid.

Additionally, as the case proceeded to the regulators, if Aurora was deemed to be the beneficial owner of the locked-up shares, it would have had to comply with the rules for an insider bid, thereby delaying their process. To back up this argument, CanniMed argued two of its directors affiliated with the locked-up shareholders passed along confidential information to Aurora and those shares should be excluded from the 50% minimum tender condition and any minority approval of a subsequent transaction.

Challenge to the Courts

Aurora appealed to the Financial and Consumer Affairs Authority of Saskatchewan and Ontario Securities Commission to cease-trade the rights plan, saying it was meant to halt its bid, was made up of unusual restrictions that were inconsistent with the newly established takeover bid rules, and restricted CanniMed shareholders from tendering. Aurora also asked that the 105-day minimum bid period be reduced on the basis of the Newstrike deal constituting an alternative transaction, thus rendering the need for 105 days to find another offer obsolete.

What the Regulators Said

The regulators placed importance on the predictability the new takeover bid regime was meant to achieve with clear, stable rules governing the market and providing increased certainty to market participants.

The regulators cease-traded the rights plan on the basis of it being an impermissible defensive tactic and "primarily a tactical motivation". They also did not accept that the rights plan would help facilitate higher bids, as CanniMed was restricted from seeking suitors under its deal with Newstrike and shareholder choice was not being limited because they had the opportunity to vote on the Newstrike deal before the Aurora offer expired.

Among other things, the regulators also pointed out lock-up agreements are legal and take on increased importance for a prospective bidder under the new takeover rules because the 105-day bid period adds increased uncertainty. If a tactical rights plan served to block a lock-up and buying in the market, the new takeover regime would become far less predictable and may discourage accretive transactions.

With regards to Aurora's arguments, the regulators disagreed that the Newstrike deal was an alternative transaction as it did not involve the acquisition of CanniMed shares, included customary fiduciary outs, and the only reason the transactions were mutually exclusive was the condition Aurora included stating it would only proceed if the Newstrike deal was voted down. The result was that regulators disagreed with the bid period being shortened in this instance.

Figure V

CANNIMED'S SHAREHOLDER RIGHTS PLAN WAS CEASE-TRADED AS THE SECURITIES REGULATORS CHOSE NOT TO CHANGE THE PROVISIONS OF THE NEWLY ESTABLISHED TAKEOVER BID RULES AND STATED THAT THEY DID NOT HAVE THE EVIDENCE TO FIND AURORA AND LOCKED-UP SHAREHOLDERS TO BE JOINT ACTORS.

CanniMed Shareholder Rights Plan	Ontario and Saskatchewan's View
Definition of "permitted bid" did not allow for automatic reduction of 105-day minimum deposit period in event of an alternative transaction	Definitions should not trump clarity and stability provided by takeover bid rules
Prevented additional lock-ups	Permitted and needed even more as bidders try to manage uncertainty in longer 105-day bid period
Deemed Aurora as beneficial owner of locked-up shares	Disagreed that a rights plan's definitions should trump the takeover bid rules but required Aurora to amend circular to disclose information had been obtained from someone who had a special relationship with CanniMed
Prevented additional market purchases	Allowed market purchases
Needed to permit potentially higher bids	No evidence CanniMed intended to seek other transactions at the time. Deal with Newstrike prohibited seeking superior offers while in effect
Needed to permit shareholder choice	Choice already existed with vote on Newstrike deal before Aurora bid expired

What This Means

Use of tactical poison pills. There still may be a role if it could be demonstrated the pill was needed to ensure shareholder choice, and provided the pill does not seek to duplicate or layer onto the requirements of the takeover bid regime with additional, and likely confusing, discrepancies about how the requirements should be fulfilled.

Lock-up agreements. Hard, unconditional lock-up agreements are fair game and may even have an increased role under the new rules that introduce increased uncertainty with a longer 105-day bid period.

Joint actor status. Just because an insider may have shared material non-public information in an attempt to help thwart a potential deal and structure another with an outside party, this does not necessarily mean they were acting jointly if they are on different sides of the transaction being challenged and, as shareholders, they were simply seeking the best available outcome.

The Deal Goes Friendly

On January 24, 2018, Aurora and CanniMed announced an end to the takeover battle with a friendly $1.1 billion deal, at the time the largest transaction in the history of the fledgling Canadian cannabis industry. The agreement tendered CanniMed shares at a much higher price of $43.00 each, a 185.53% premium over the November 13, 2017 closing price. Notably, the transaction excluded Newstrike thereby triggering the $9.5 million break fee payout.

Kingsdale's Take

Balance between the target and the bidder is paramount in the eyes of the regulators. In light of this, employing a tactical pill will face an even tougher uphill climb than many thought under the new rules. If a pill is adopted, a premium must be placed on demonstrating it is necessary to allow shareholders to make decisions in their own interests.

In instances where a board is seeking to extract more value from a potential alternative bidder, the absence of a tactical pill may make it harder for a white knight to be ensured support if the original bidder is able to continue to purchase shares in the market and, coupled with locked-up shares, create a blocking position.

One consideration is how the regulators would view a tactical pill that was approved by shareholders. Shareholder-approved rights plans meant to prevent creeping takeovers are likely not impacted by this decision. Finally, as the regulators noted, lock-ups will take on increasing importance moving forward.

We're Canada's leading strategic shareholder advisory firm, having acted on the largest and most high-profile proxy fights and transactions.

Kingsdale is more than just a proxy solicitor; we are a trusted strategic advisor to management and boards on everything from governance to M&A to crisis communications.

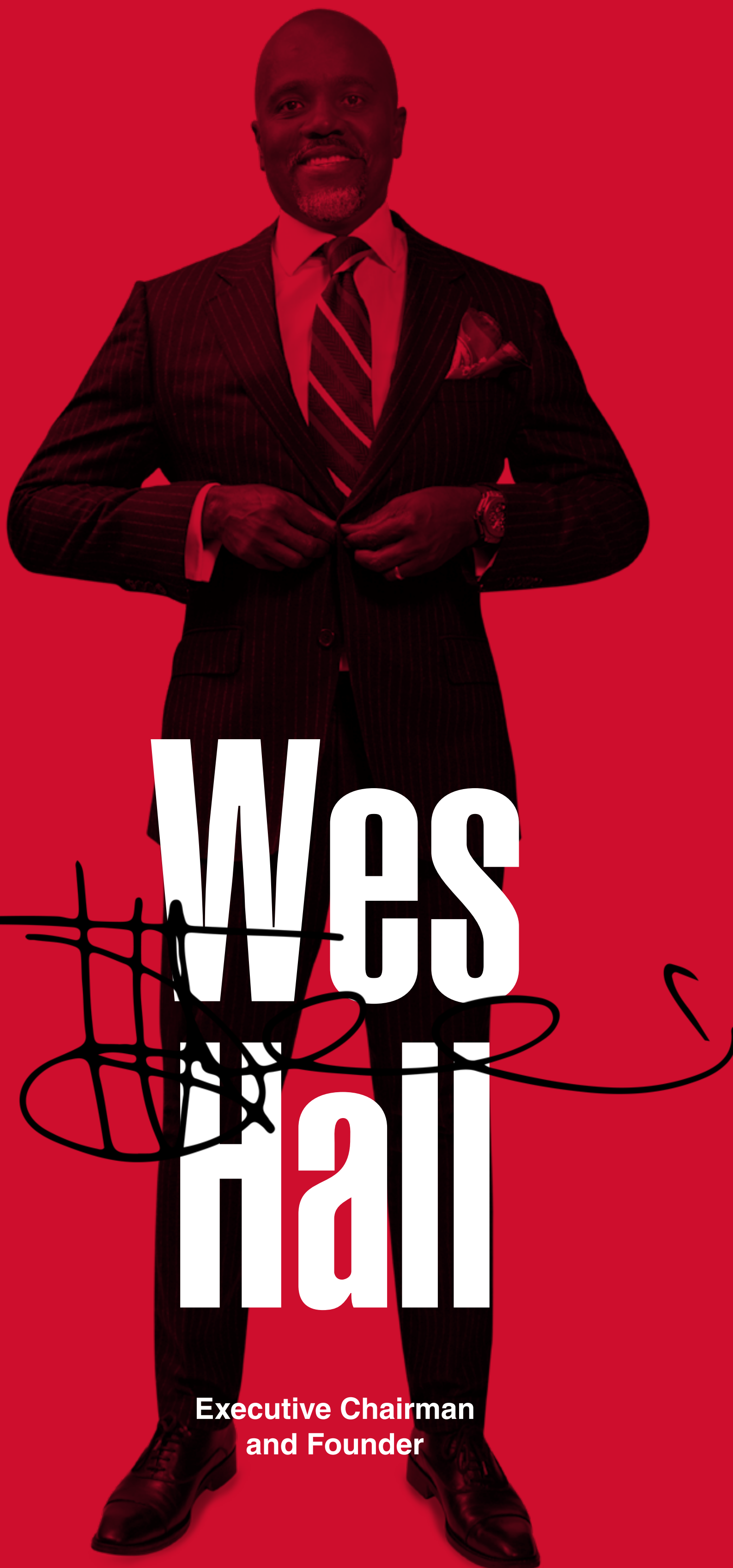
Our expert team of dedicated industry professionals is committed to providing individualized client solutions designed to suit your unique needs.

Kingsdale focuses on your shareholders so you can focus on your business. With our multidisciplinary team of governance, legal, operations, and communications experts, we structure winning proxy solicitation strategies by effectively communicating and engaging with shareholders, analyzing proxy voting patterns, and providing expert governance advisory services to ensure compliance with a changing regulatory environment.

Services:

- Defensive & Strategic Advisory
- Governance Advisory
- Compensation Advisory
- Mergers & Acquisitions
- Communications
- Proxy Solicitation
- Creative
- Asset Reclamation
- Information Agent
- Debt-Related Services
- In-Sight Voting Analytics

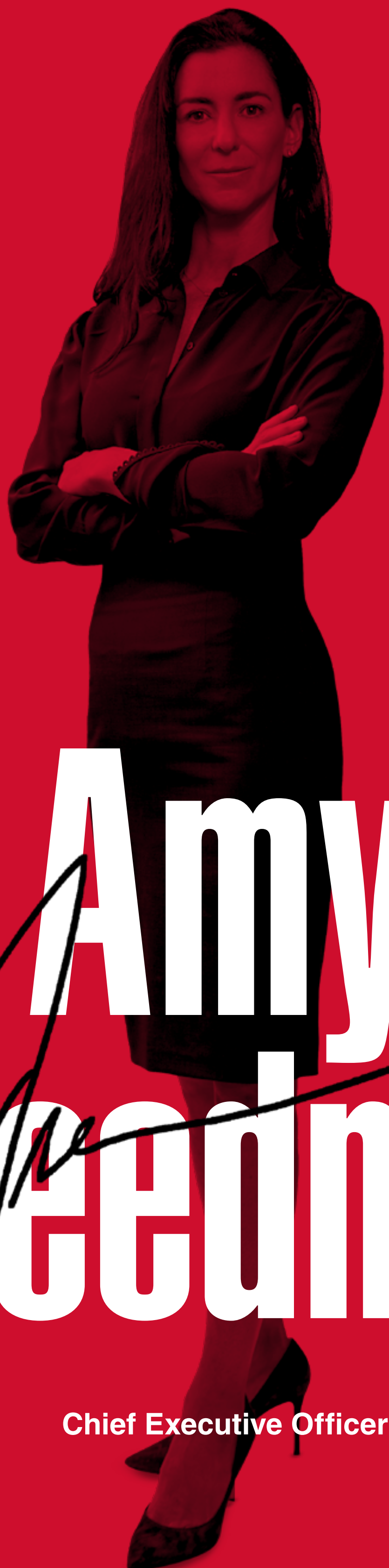
Expert. Innovator. Entrepreneur.
With over 20 years of experience in corporate governance and shareholder communications, Wes has established himself as the preeminent leader in shareholder advisory services and proxy solicitation. Canada's leading newspaper, *The Globe & Mail,* has called him one of the nation's "most influential powerbrokers" and *Canadian Business* magazine named him one of the "most powerful business people".



Wes Hall

Executive Chairman and Founder

Amy joined Kingsdale in 2014 as an Executive Vice President and became CEO in January 2017. A seasoned capital markets professional, with over 12 years of experience in investment banking, Amy is responsible for the day-to-day operations of Kingsdale Advisors, with a focus on providing superior service and outstanding strategic advice to public company boards and management as they strive to enhance value for shareholders.



Amy Freedman

Chief Executive Officer

Victor is a veteran in corporate governance advisory with a special focus on shareholder activism and contested situations. Prior to joining Kingsdale Advisors, Victor was Vice President of M&A and Proxy Contest Research for both of Institutional Shareholder Services Inc.'s U.S. and Canadian research teams, where he covered and provided vote recommendations for over 80 North American proxy contests as well as more than 1,000 M&A transactions to institutional clients.

Victor Guo

Executive Vice President
Governance Special Situations

Grant has over 30 years of international experience, predominantly in financial services, spanning Canada, the U.K., and Australia. Grant heads Operations at Kingsdale Advisors and is closely involved in all aspects of Kingsdale's proxy, corporate actions, and shareholder outreach services.

Grant Hughes

Chief Operating Officer

Victor has over 18 years of experience in corporate governance advisory and capital market research. Having joined Kingsdale Advisors from leading Institutional Shareholder Services Inc.'s Canadian M&A and proxy fight research team, he launched and now oversees the Governance Advisory division of Kingsdale to prepare insightful analyses for corporate clients on their governance practices, executive compensation disclosure and structure, stock option plans, shareholder rights plans, proxy contests, and mergers and acquisitions – friendly or hostile.

Victor Li

Executive Vice President
Governance Advisory

Ian is a strategic communications professional with over 18 years of experience in nationally and globally competitive sectors. Ian has established Kingsdale's communications practice as the leading proxy fight PR specialist, handling more contested situations than any other PR firm since 2014. He was recently named one of M&A Advisor's Top 40 Under 40 Emerging Leaders, the only Canadian in his award category among a list of U.S. award winners.

Ian Robertson

Executive Vice President
Communication Strategy

Michael leverages over 25 years of experience on Wall Street to help clients achieve their objectives in shareholder elections, with a particular focus on transactions and activist campaigns. His expertise spans corporate governance, executive compensation, and special situations. Michael's extensive buy-side experience makes him unique in the valuable insight he is able to provide corporate clients about how to best generate investor support.

Michael Fein

Executive Vice President
Head of U.S. Operations

AN UNMATCHED BREADTH OF EXPERIENCE

Select 2018 Client Wins

Proxy Fight

Crescent Point cation CAPITAL

- Cation Capital, an activist with 0.3% ownership, requested four of 10 board seats at Crescent Point's annual meeting just one day before the deadline under the company's advance notice by-law
- ISS recommended shareholders vote for activist nominees; Glass Lewis recommended for management's slate
- Kingsdale worked with Crescent Point to reach out to key institutional shareholders to counter ISS' recommendation
- Kingsdale organized and led an extensive public relations and retail outreach campaign ensuring shareholders were aware of the company's plan to build value
- The result was a clear victory with all 10 management nominees elected

Strategic Communications & Hostile Bid Defence

CanniMed Therapeutics Inc. AURORA

- Proposed friendly merger between CanniMed Therapeutics and Newstrike Resources turned into a hostile bid defence when Aurora Cannabis swooped in looking to take over CanniMed and block the deal
- Kingsdale's aggressive public relations and advertising campaign and shareholder outreach strategy turned the tide in CanniMed's favour despite an initial 38% of shares locked-up against the deal
- With insurmountable resistance to the hostile bid, Aurora approached CanniMed and negotiated a new offer, increasing its offer from $29.00 to $43.00 in shares

Amalgamation Agreement

imvescor inc. MTY FOOD GROUP

- Imvescor Restaurant Group Inc. and MTY Food Group Inc. entered into an amalgamation agreement under which a subsidiary of MTY would acquire all of the outstanding shares of Imvescor for a total aggregate consideration value of $247 million
- Kingsdale was retained to address public concerns made by Imvescor's largest shareholder, ADW, holding 14%
- Kingsdale executed a comprehensive shareholder outreach campaign resulting in over 66% turnout, with the transaction receiving overwhelming approval from 92.73% of votes cast at the meeting

Balance Sheet Recapitalization

CONCORDIA INTERNATIONAL CORP

- Precedent-setting recapitalization under CBCA Plan of Arrangement, with concurrent and contingent vote eligibility under U.S. Bankruptcy Code Chapter 11 and Canadian CCAA
- Concordia engaged Kingsdale to help get approval on its POA to restructure US$2.1 billion worth of secured debt, and US$1.6 billion worth of unsecured debt along with a new equity raise of US$586 million
- Kingsdale established voting channels for secured and unsecured debt on a first-of-its-kind CBCA and Chapter 11 simultaneous vote, with 99.78% turnout within the secured class and 97.80% of the unsecured class all voting 100% for the POA
- After the meeting Kingsdale worked with financial advisors to determine payments and acted as escrow agent for all cash payments

Take it Private

NAPEC OAKTREE

- Napec Inc. entered into a take-private acquisition with Oaktree Capital Management for $320 million
- Kingsdale was retained to increase turnout and develop strategies to manage large opposition amounting to ~27%
- Napec's second-largest shareholder, with 14.39%, publicized their opposition to the transaction midway through the campaign with potential to influence other shareholders
- With an extensive retail and institutional outreach campaign, Kingsdale was able to drive turnout to 89% and overcome opposition, with 71% voted in favour of the acquisition

Restructuring Support

BANRO CORPORATION

- Banro Corporation initiated a recapitalization plan under CCAA to convert all its existing debt into private NewCo equity
- Kingsdale acted as strategic advisor to operationalize the plan providing information agent, exchange agent, and meeting scrutineer services, creating a unique process enabling creditors to deposit their bonds for cancellation and provide registration instructions for new equity through CDS, which was then used for the NewCo register
- Kingsdale worked with all of these holders to provide completed know-your-client and anti–money laundering documentation as required by the NewCo transfer agent in the Cayman Islands

2 Issues on the Horizon

The New Reality of Decentralized Voting

For a very long time, public companies have been paying much attention to proxy advisory firms such as ISS and Glass Lewis because the recommendations of such for-profit entities have influenced virtually every corporate vote. In fact, more resources have been allocated to ensure favourable recommendations by ISS and Glass Lewis than to engage directly with the vote decision makers at institutional shareholders.

The reason? Institutional shareholders had historically farmed out vote decisions to – and closely followed the recommendations made by – proxy advisors.

The new reality? Institutional shareholders have started to take back the decision-making process *(a concept we explore further in our article Why Passive Investing Doesn't Mean Passive Voting on page 41)*. Proxy advisors have become more and more like data aggregators, summarizing the key facts of the proxy materials instead of putting their firms in the centre of proxy voting.

Recently, an analyst at a non-profit shareholder advocacy group uncovered a mistake in how ISS had cast proxy votes for a pension fund client – supporting all 467 of its say-on-pay votes during the 2017 proxy season – due to an internal miscommunication within the ISS team. This cautionary tale has prompted the pension fund to have quarterly calls with ISS to review the proxy votes. While somewhat of an extreme example, investors are taking a more serious stance on the proxy voting process. They may have outsourced all elements of the process but they still need to make sure the votes actually reflect the investor's view.

Proxy Advisors Prefer to be Left out of the Centre and Follow the Collective View of Their Clients

In its June senate hearing statement, ISS claimed that “proxy advisory firms do not ‘control’ shareholder votes” and shareholders ultimately have to make their voting decision. In fact, we have observed that ISS tends to follow investors on governance policy, not lead them. The proxy advisors regularly survey the market before assuming what would be considered a leading-edge position. For example, to develop policy updates for the 2019 proxy season, ISS is requesting feedback on the following proposals that it is contemplating including in its proxy analysis:

- Whether to include a note in proxy research about directors who had oversight failures (on risk, protection of shareholder rights, and stewardship of compensation practices) at other boards

- What type of voting recommendations to make at companies that lack any gender diversity on their boards

- For dual-class companies, whether to provide an adjusted analysis of shareholder vote results to show what the results would have been if all votes had been counted under the one-share, one-vote principle

- For ISS’ pay-for-performance quantitative screen, supplementing or replacing existing GAAP-based accounting metrics in the Financial Performance Assessment with Economic Value Added-based metrics to measure corporate economic performance

Using gender diversity as an example, some investors have been pushing harder on companies with no women on a board by withholding votes from the governance or nominating committee chair. ISS is just playing catch-up.

Investors Differentiate Themselves by Having Their Own Custom Proxy Voting Policies

Keep in mind the ISS vote recommendations quoted by the market are those derived based on ISS’ “benchmark” policies. In total, ISS applies over 400 policies to shareholder meetings, including country/region-based benchmark policies, specialty policies such as Taft-Hartley and public fund policies, along with custom policies defined by ISS’ clients.

There may be a competitive advantage for large pension funds or asset managers to develop and evolve their custom policies. Some institutional policies may even be product features for underlying client appetite. By owning their internal policies, investors can demonstrate the stewardship required by their stakeholders. By being more lenient on some matters and stricter on others, investors can signal to the market their beliefs on governance issues and set their engagement agenda to promote changes. Proxy access and gender diversity movements are good examples.

Contested elections or M&A transactions also prove that many investors make up their own mind when the stakes are high. In the case discussed earlier, at Crescent Point Energy’s contested 2018 annual general meeting, while the activist proposed four nominees and urged voting down the say-on-pay proposal, none of the activist nominees was elected, notwithstanding that ISS supported two. Say-on-pay, on the other hand, failed, receiving only 38.52% support.

Knowing Your Shareholders and Conducting Regular Shareholder Engagement are Key to a Successful Vote

With shareholders taking back the vote decision, for public companies, the task of knowing your shareholders is becoming more important – a point we make repeatedly – and more nuanced. The first question remains, do they subscribe to ISS or Glass Lewis?

But nowadays, this knowledge alone is not enough. You need to know who makes the vote decisions and how. Consider:

- Do shareholders vote based on their custom policies? Have you checked their past voting records?

- When the policies are vague, under what situations can discretion be applied? Will the portfolio managers have a say in the voting decision?

- Is your information or relationship up to date due to policy changes and staff turnover? When is the last time you talked to the vote decision makers? What did they say?

A Council of Institutional Investors review of shareholder votes in 2018 reveals that most matters that go to votes are supported by boards, proxy advisors, and shareholders, with conflict centred on relatively few proposals. Even among nominees facing adverse voting recommendations from ISS, 99% won a majority of votes cast with median 86% support. So, the reality is that ISS no longer dictates the votes – if it has ever truly done so.

This also shows that companies should promptly respond to low vote results given how rarely shareholders opt not to side with management. Regular engagement with your shareholders can not only build a long-term relationship but also ensure a positive vote when it is really needed.

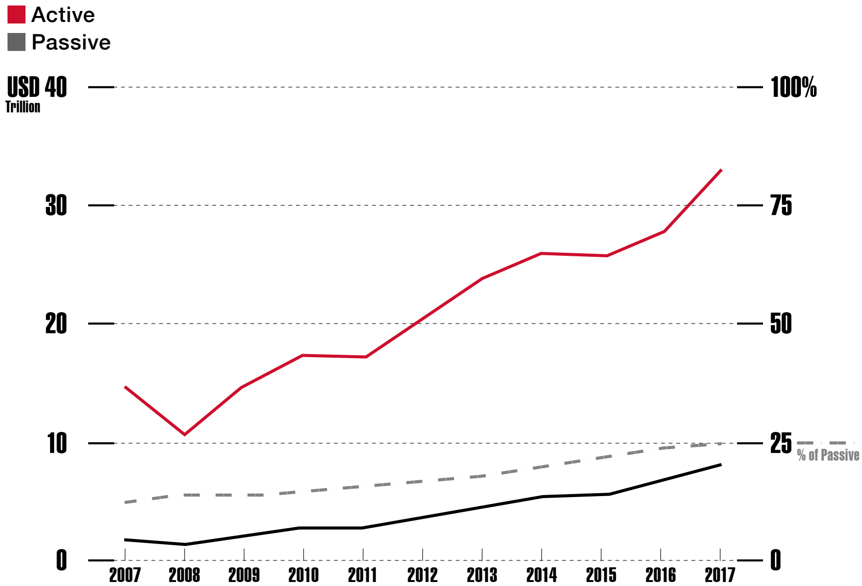
Designing proposals with shareholder – not just proxy advisor – intelligence in mind is now the name of the game.

WHY PASSIVE INVESTING DOESN'T MEAN PASSIVE VOTING

An inside look at the voting practices of ETFs and other passive investors

Passive investing has skyrocketed, with assets under management in index funds and ETFs representing US$8.1 trillion globally or 25% of all fund assets, up from 12% a decade ago. The reason for this growth is simple: ETFs have largely democratized access to investment securities for retail and institutional investors alike as a low-cost, liquid, and generally superior investment vehicle relative to the active managers struggling to consistently beat their annual benchmarks.

Figure W



Source: Morningstar Direct, excluding money market funds and funds of funds

With Great Power Comes Great Responsible Investment

The shift to passive management, however, hasn't led to a reduction in the stewardship of those investments like many feared. In fact, it is flourishing.

Leading global index managers such as BlackRock and Vanguard are taking active roles in the oversight of their portfolio companies as the largest stewards of governance and fiduciaries of client capital. Why? What quantifiable metrics would lead a six-trillion-dollar asset manager to abscond from its low-cost, low-maintenance approach and focus on hiring sector analysts and regional experts to monitor their portfolio? In their words: active ownership over passive investments exercised through voting and engagement mitigates risks and leads to increased long-term performance.

ETF Shareholders: The Ultimate Long-Term Investors

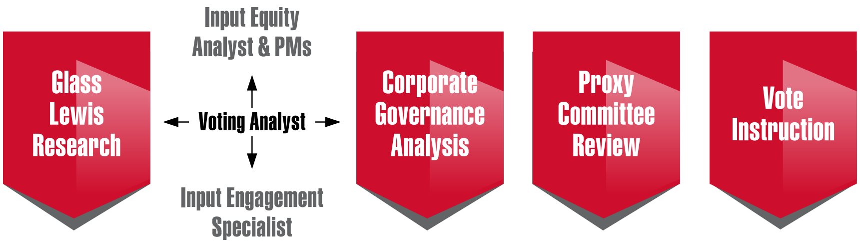
Unlike active managers, index funds can't simply sell their stock in poorly run companies. Thus, they have no choice but to focus on the long term. They are more concerned about the board's decisions over the next decade than over the next quarter, and as the largest shareholders in the firms they own, they are uniquely placed to drive change that benefits shareholders.

Redefining "Active Ownership"

How are passively held shares voted? The answer depends on the asset manager. While it's true that a shrinking number of shops blindly follow the recommendations of ISS or Glass Lewis, many have built large in-house governance groups that coordinate outreach, research ballot items, and make voting decisions independent of the proxy advisors. Input from portfolio managers, analysts, and specialists is factored into the analysis, though the final decision will vary depending on the firm.

Figure X

Vote Decision-Making Process



Source: RobecoSAM Governance & Active Ownership Team

At BlackRock, while voting is centralized across all funds and handled by the global governance team, the policy allows active fund managers to vote independently of their passive funds. This contrasts with the Vanguard and State Street governance teams that have full authority to vote all funds, allowing them to leverage their full-scale voting power and limiting conflict of interest. In almost all cases, index portfolio managers have no say in the voting of their holdings.

Navigating the Governance Tide

BlackRock votes at more than 15,000 shareholder meetings annually, totalling over 130,000 proposals. Last year, they engaged with 1,500 of these portfolio companies and are expected to increase this target. Passive funds are investing heavily in the governance space. BlackRock's stewardship team now totals over 30 people, up from 20 just a few years ago. UBS has over 10 people, and smaller passive managers like Dimensional Fund Advisors have three. Retaining industry specialists means extra fees and, while large managers can absorb the additional cost, it will be a challenge for the smaller firms without increasing their fees. Outsourcing for some is the only option while they build their internal framework.

Figure Y

ETF Provider	Passive AUM ($)	% Supports Management	% Matches ISS	% Matches GL
BlackRock	$3,333,132,796,432	91.00%	93.00%	86.00%
Vanguard	$3,209,016,458,191	94.00%	94.70%	85.10%
State Street	$1,356,014,167,855	88.90%	93.10%	85.00%
Invesco	$422,670,222,840	92.60%	95.45%	90.70%
Northern Trust	$417,774,672,964	91.40%	96.70%	86.40%
Fidelity	$221,036,805,189	88.35%	93.25%	89.10%
Charles Schwabb	$198,141,678,104	87.30%	88.10%	98.30%
First Trust	$70,190,350,000	91.45%	99.90%	90.25%
PIMCO	$48,428,209,982	92.30%	99.45%	87.70%
Van Eck	$35,827,320,000	82.60%	84.70%	98.60%
Average	**$931,223,268,156**	**89.99%**	**93.84%**	**89.72%**

An analysis of votes from 10 of the largest passive fund managers over the last five years shows that most are far from blindly supporting management or outsourcing to ISS/Glass Lewis. Each has excercised an active vote over the passive funds.

Kingsdale's Take

Issuers need to ensure that the governance groups of their passive shareholders are included in their regular engagement cycle. Asset managers in turn are increasing their engagement to meet expected demand, with set guidelines for issuers to follow regarding participants and discussion topics.

As capital inflows into passive funds continue to grow and responsible investment increases across asset managers, it is imperative that issuers be regularly engaging with the decision makers who wield their ever-increasing vote power. The largest passive managers are setting the bar high and will continue to use their substantial influence to pressure companies to improve their ESG and financial disclosures.

For issuers, this doesn't just mean setting up engagement meetings in times of crisis. Engagement can take many forms (event-driven, topic-driven, or strategy) with each providing the opportunity to provide rationale for ballot items, discuss proposed changes or, in the words of Vanguard, "ensure that bumps in the road are treated with the appropriate context."

Figure Z

Investor engagement falls into three categories

Event-driven

Meetings to address an issue with a ballot item during proxy season (i.e. ISS' against recommendation on an option plan or investors withhold vote on a director). Held with both management and activists during proxy contests.

Topic-driven

Meetings to discuss topics that fall under the board's responsibility (i.e. board composition, compensation, and governance disclosure).

Strategy

Meetings to discuss a company's long-term strategy so bumps in the road are understood in the right context. These are generally held outside proxy season.

Source: The Vanguard Group Investment Stewardship

IN THE CROSSHAIRS: REITs, CANNABIS COMPANIES POISED TO BE ACTIVIST TARGETS

While no industry is immune to activist attacks, we expect to see increased activity in the real estate investment trust (REIT) and cannabis industries going forward.

On the surface, these two industries appear to be as different as chalk and cheese. One is an industry that emerged from the real estate crash of the 1990s and, in recent years, has exhibited significant value gaps. The other is a burgeoning sector with rapidly increasing valuations buoyed by marijuana legalization in Canada and other jurisdictions around the world.

What the two industries do have in common, however, is a propensity for deficient governance structures that make them vulnerable to activist attacks.

Why REITs Are Vulnerable

For the past two and a half decades, investors with their money in REITs have had little to complain about. Over that period, the industry experienced robust growth and is now valued at approximately $60 billion. This success shielded REITs from activism; non-operational matters such as corporate governance best practices were not often top of mind for management or investors.

But now that REITs have started to show signs of value gaps, their governance and compensation practices have come under greater scrutiny. Here's why:

REITs are not governed by corporate statutes but rather their own declaration of trusts, many of which were drafted before the millennium. CCGG has long advocated for the amendment of public REIT constating documents to add certain model provisions that provide the same level of basic investor rights as provided in corporate statutes. Some REITs, for example, only allow for meeting requisitions by unitholders not holding less than 10% of the units while the CBCA equivalent threshold is 5% of shareholders.

REITs are often led by founder-CEOs who control the management companies providing services to the REIT. A remnant of the trust fund model, these related party transactions between the REIT and the management companies often become a focal point in proxy contests. REIT management agreements often have incentives that, while on the surface look appropriate, are open to abuse. Examples include fees linked to AUM and/or renovation capex. While designed to grow the REIT and drive occupancy revenue, these incentives can motivate the manager to put forward properties (from related entities) at inflated valuations and overcharge for renovations.

REITs, given their flow-through characteristics, are attractive to retail investors. As opposed to traditional institutional investors, retail investors demonstrate a higher degree of voter apathy. Even today, some public Canadian REITs have voter turnout percentages in the low teens. This means an activist with a relatively small position who will actually vote can have a big impact on the outcome.

Why Cannabis Companies Are Vulnerable

As was the case with REITs, the good times and rapid growth in the cannabis industry have left the corporate governance practices of many cannabis companies wanting.

In meteoric fashion, some of the now-large cannabis companies have graduated from the TSXV to the TSX, and in some cases the S&P/TSX Composite Index. While this has created huge returns for seed investors, it has also dramatically changed shareholder bases: large cannabis companies have started to see a turnover from retail to institutional investors, who place more importance and scrutiny on board governance.

A recent example of this was Canopy Growth Corporation's $175 million bought deal led by BMO Capital Markets and GMP Securities. In fact, our analysis of the major companies in the cannabis space shows a considerable increase in the number of institutional shareholders: in some companies, institutional ownership has increased threefold.

We expect to see continued consolidation through M&A activity in the short term, and encourage issuers to be on the lookout for activist shareholders able and willing to elect directors who are out of step with the current thinking and strategy of the company. Institutional shareholders are also more adept at running independent M&A valuation analyses and we can expect them to be more discriminating in supporting M&A activity in the future than retail investors.

How Can Companies Protect Themselves?

Know your shareholders. Unitholder or shareholder engagement remains one of the best forms of activist defence. For traditional institutional investors, make sure that engagement involves the governance teams rather than just portfolio managers. In the case of REITS, if unitholder turnout has historically been low, or in the case of cannabis companies with no or few annual general meetings previously, thinking about ways to improve voter turnout and making sure your key corporate messages are being received would serve companies well before activists show up.

Independent leadership. Ensure that there is independent leadership to the board; a combined Chairman/CEO position is not effective governance.

Pay attention to executive compensation practices. Change-of-control provisions are under particular scrutiny, especially in an industry poised for consolidation. Canadian best practice dictates that employment contracts with executives contain double-triggered change-of-control provisions with severance payments not exceeding double the cash salary and bonus.

Adopt a say-on-pay vote. This will help shield compensation committee members in the event there are compensation concerns and is a sign of good corporate governance.

Watch related party transactions. Any related party transactions with independent directors outside the purview of the independent directorship should be closely scrutinized and avoided if possible.

Keep an eye on board independence. If there are familial relationships on the board, think about board refreshment that could improve both perceived board independence and the actual independence.

The good news is that there are proactive steps companies in the cannabis and REIT industries can take to strengthen their governance and avoid having their hand forced by a negative shareholder vote. Don't wait until it's too late.

THE FUTURE OF VOTE BUYING IN CANADA

Why the days of soliciting dealer arrangements should be numbered

This spring, the Canadian Securities Administrators (CSA) sought comment on the use of soliciting dealer arrangements both in the context of mergers and acquisitions and in proxy fights. In M&A, the practice has long been accepted where unconflicted directors recommend a transaction, but in proxy fights, it has faced significant scrutiny and overt criticism by numerous interested parties for whom the practice of paying brokers for their time has morphed into paying for support of an incumbent board – or vote buying.

In a proxy fight, the arrangement is offered by the issuer to brokers whose clients own and vote their shares in support of the company's chosen slate. The payment is only made to brokers whose clients vote for the company's slate – not any vote – and if the company wins.

The issue of vote buying in proxy fights was thrust back into the headlines in the summer of 2017 in the case of PointNorth Capital vs. Liquor Stores N.A. (now renamed Alcanna) and served as the catalyst for the CSA's request for comment.

While the practice in the context of proxy fights has been controversial, it has not violated the law nor has it been shown to breach the public interest purview of securities regulators.

In the past, we have been critical of regulators who play the role of a police officer watching a street fight, only to intervene once a victor has been declared and the dust has settled. As we are hopeful that that is changing, we applaud the CSA for considering how the practice's failure in the court of public opinion should influence the regulator's approach and weigh on the public's interest.

Why Soliciting Dealer Arrangements Have Been 'Needed'

The shareholding system in Canada is renowned for the barriers it throws up for issuers, bidders, or shareholders to contact retail objecting beneficial owner (OBO) shareholders directly. With this comes the drive to look for new and innovative ways to penetrate this system.

The use of soliciting dealer arrangements has migrated from usage in takeover bids conducted via a tendering process to transactions conducted by way of a shareholder vote. Within the latter category, soliciting dealer arrangements further moved from being used in board-supported and recommended transactions to ones where a board has a conflicted or entrenched position. Even within the M&A context, arrangements have gone from compensating brokers for their time to reach out to shareholders, to compensating them to help achieve a particular result.

It is important to understand the main differentiator between the use of soliciting dealer arrangements in transactions vs. proxy fights. In the former, a recommendation to tender to an offer or vote for a plan of arrangement is made by an unconflicted sub-committee of independent directors of the board, the basis for which is grounded on a relatively empirical and objectively verifiable set of facts – specifically the price the offeror is prepared to pay compared to the intrinsic value of the company and the availability of superior strategic alternatives, including the go-it-alone alternative.

In the latter case, a vote appeal is made by a conflicted set of directors who are interested in self-preservation, have access to corporate funds, and base their views on highly subjective data points such as how they think they are doing in their roles and how well they could do going forward. Equally subjective in a proxy fight scenario are the merits of the activist's nominees and their likely contribution to, or disruption of, the board.

In both cases, caught in the middle you have brokers who have been placed in a position of trust by their clients, expecting them to act in the best interest of the client, not the broker. In most cases, the broker is not qualified to assess the relative merits of the company vs. a dissident slate and accompanying business plan, but certainly has an incentive to recommend one over the other when a soliciting dealer arrangement is in place.

Soliciting dealer arrangements have been used in excess of 40 times in the context of M&A and three times in proxy fights. Four of those cases – three proxy fights and a recent hostile bid – are worth expanding on.

2012

Octavian Partners LP vs. EnerCare Inc.
Only 12 days prior to the annual meeting, EnerCare announced it intended to pay a fee of $0.05 for each share voted by shareholders against Octavian's board nominees provided that a minimum of 1,000 shares were voted, subject to a minimum fee of $100 and maximum of $1,500 per account.

Octavian immediately hit back, accusing EnerCare of "an extraordinary abuse of power and waste of company resources that highlights the lengths to which the current directors will go to further entrench themselves." EnerCare was majority-held by retail investors – more than 75% – thus proving a worthwhile strategy to combat the considerable initial activist support.

Shareholders defeated Octavian's proposal by a vote of 19.1 million against the proposal to 15.7 million for the proposal, a difference of 3.4 million. Octavian, the largest shareholder, held 7.23 million shares – more than the 7.21 million shares held by the next 20 largest shareholders in aggregate.

2013

JANA Partners LLC vs. Agrium Inc.
Both parties used boilerplate language in their proxy circulars to reserve the right to form a soliciting dealer group (a practice that has now grown common). The implementation by Agrium, however, was not press-released and only came to light when an outraged shareholder was told by a confused broker that the shareholder would be paid for his vote.

Kingsdale, through its solicitation efforts, worked to confirm with custodial back offices that a soliciting dealer arrangement was in place and obtained the greensheet. Agrium had agreed to pay brokers $0.25 for each share held by a Canadian voted in favour of the Agrium nominees, provided that the fee was no less than $100 (as long as they held a minimum of 30 shares) and no more than $1,500. Most importantly, no solicitation fees would be payable if the slate of Agrium nominees was not elected in full to the board.

In the highly public discussion that ensued, Agrium attempted to make the case that they were simply trying to communicate with OBOs, while JANA argued that this was vote buying pure and simple. Much of the independent press, whether supportive of Agrium or JANA, found the vote buying to be inappropriate. All U.S. shareholders were surprised that soliciting dealer arrangements were and are even legal in Canada. Ultimately, Agrium saw all incumbent nominees elected, fending off JANA.

2017

PointNorth Capital Inc. vs. Liquor Stores N.A. Ltd.
Facing significant opposition, Liquor Stores set up a soliciting dealer group to pay brokers $0.05 for each share validly voted for each member of the Liquor Stores slate with a minimum of $100 and maximum of $1,500 to be paid per Canadian account. Fees would only be paid if each member of the Liquor Stores slate was elected to the board. Liquor Stores justified the action by indicating that this was done to try and reach the 49% of total shares held by retail OBOs who could only be contacted by their brokers.

PointNorth quickly responded, criticizing this as a vote buying and board entrenchment tactic given the conditions required for the payout. PointNorth also took the fight to the Alberta Securities Commission (ASC), requesting that they terminate the arrangement as a matter of public interest.

The ASC concluded, however, that there was insufficient evidence to demonstrate an abuse of the public interest, as there were no clear examples of a broker offering advice that was contrary to their professional opinion and being passed along for financial benefit. The ASC was not the only influential group to weigh in on the matter. Proxy advisor Glass Lewis was highly critical of the arrangement, calling it "an inappropriate use of shareholder capital and a violation of basic corporate governance principles." Furthermore, multiple brokers advised they would not participate in the soliciting dealer group due to the contentious nature of the fight.

In the end, the arrangement was ineffective in increasing support for Liquor Stores, with six directors resigning days prior to the meeting, clearing the way for PointNorth to take control of the board.

2016

Sprott Asset Management vs. Central GoldTrust (GTU) and Silver Bullion Trust (SBT)
Sprott launched a hostile bid for the silver and gold funds under the Central Fund of Canada. Both were almost exclusively comprised of long-term unknown retail OBOs. Many owned bullion funds for geo-political reasons and misunderstood the nature of their investment, thinking they owned actual bullion rather than in fact owning units in a fund owning bullion.

The key economic case was that units of the trusts traded at a discount to NAV and that, by tendering to Sprott, that discount would be eliminated. In effect, the typical tender offer premium was in fact the elimination of a discount.

This message was not well-understood by retail OBOs. After a drawn-out campaign that saw unitholders receive 14 mailings over 10 months, 49 press releases, and with "unitholder fatigue" set in, Sprott announced a soliciting dealer arrangement that paid out to brokers whose clients tendered to the offer, and several U.S. brokerages participated.

Sprott paid a soliciting dealer fee of US$0.1358 per GTU unit and US$0.0448 per SBT unit deposited subject to a minimum fee of US$50.00 and a maximum fee of US$1,500.00 with respect to each beneficial unitholder of GTU or SBT and a minimum deposit of 300 GTU units or 1,000 SBT units.

On the final extension of the offer, Sprott included a power of attorney to vote at a unitholders' meeting. Ultimately, in the case of GTU, Sprott secured over 50% tendered and used this to requisition and hold a unitholders' meeting to replace the incumbent trustees, who then supported the subsequent plan of arrangement transaction, which passed. Sprott negotiated with Central Fund that they would withdraw their offer on SBT if Central Fund did not contest GTU's meeting.

The Big Questions

Where does the responsibility for shareholder outreach and engagement lie? In our view, the responsibility of engaging shareholders is one that rests with issuers, not brokers, and does not simply start when a proxy contest requires it. Ongoing engagement with all levels of shareholders in and outside of a contested situation or transaction is a sign of good corporate governance and is illustrated in a regularly high turnout of voters at shareholder meetings.

Are dealer arrangements fair to brokers? Most brokerage houses have transferred voting responsibility to specialist in-house governance teams for managed portfolios. These governance teams often have mature proxy voting policies and guidelines. Retail brokers are trained to provide investment advice, but not in the myriad of issues that may present in the case of a contested vote. Dealer arrangements outside of traditional M&A situations put brokers into a conflicted situation of providing unqualified advice for a fee. We note that in the Liquor Stores case, some brokerage firms simply refused to participate in the dealer group, reflecting this conflict.

How effective are soliciting dealer arrangements to the ability of companies to contact retail OBOs? Questionable. Dealer groups are often put in place as "insurance" to help drive OBO participation given the opacity issuers face with regard to the OBO shareholders. However, dealer groups themselves operate under the same veil of client anonymity, with little transparency into the underlying shareholder engagement. Dealer arrangements are particularly open to abuse by brokers with discretionary authority who do not require client instructions and can act entirely in their own interests. Discretionary accounts are common in the OBO space, particularly high net worth where voting entitlements are highest amongst retail shareholders.

Where do the proxy advisors line up? It is important to note the views of ISS and Glass Lewis. If the soliciting dealer fees are not conditional on favourable votes or outcome of the voting results, and are for the legitimate use of encouraging more vote participation from shareholders in uncontested meetings, proxy advisors consider such a practice generally acceptable. However, proxy advisors do not support soliciting dealer fees paid conditionally on favourable votes or outcome of the voting results, viewing such a practice as inconsistent with the basic tenets of shareholder democracy.

It is worth noting the timing of the announcement (or revelation) of the soliciting dealer arrangements in the examples cited. In the case of EnerCare, it was announced after the ISS recommendation fully in favour of management. In the cases of Agrium and Liquor Stores, ISS supported some of the dissident nominees. While we don't know the exact date, the timing was likely after ISS' recommendation in both cases. Management will run into high risk if ISS is aware of the arrangement before issuing its recommendation.

Would views change if a well-funded activist bought votes? Most, if not all, of the discussion regarding soliciting dealer arrangements has been focused on the issuers' use of the practice. Consideration should, however, be given to what would be appropriate in circumstances where an activist shareholder wishes to employ the tactic. Unlike a board, which will be using the company's coffers to fund its campaign, an activist shareholder could fund the campaign on their own. If an activist were to employ such a tactic, does this create an unfair advantage that new guidance or rules should allow a company to match? While not in the context of a proxy fight, this was done in the case of Sprott vs. Central GoldTrust and Silver Bullion Trust, where there was clear evidence that inactive retail OBOs were preventing an economically sound offer from being contemplated and there was an inverse case of the activist having potentially deeper pockets.

The Case Against Vote Buying

In general, our view is there is nothing wrong with permitting soliciting dealer arrangements, provided:

a. shareholders are properly informed of and understand the arrangement by those a shareholder has entrusted their money to, being both the issuer and the broker-dealer; and

b. the arrangement creates a level playing field in that solicitation is made evenly and fairly for any votes received and payment is not conditional on one side winning, thereby restoring the original basis behind broker payments – to compensate them for their time spent reaching out to securityholders.

The problem is that in each instance where soliciting dealer arrangements have been used in a proxy fight, neither has been true. Consideration should be given as to what constitutes adequately informing shareholders, including the time required to consider and digest the information. If you consider market practice for advance notice by-laws in Canada, 30 days may be appropriate.

Where one or both of these provisions are absent, the potential for abuse of shareholders, broker conflicts of interest, board entrenchment, and exploitation of the integrity of the proxy voting process exists. Even in the thought experiment some have proposed, where a board would provide compensation for all votes received and not tied to outcome, brokers would still only see a greensheet from the incumbent – and therefore conflicted – board.

In the U.S., broker-dealers have stringently avoided giving voting advice to their clients. Even in the Agrium and Liquor Stores cases, U.S. broker-dealers chose not to participate. Two main reasons for this are a legal duty to act in the "best interests" of clients, a fiduciary standard, vs. to act "fairly, honestly and in good faith" in Canada, and a desire to avoid SEC filing requirements related to the proxy solicitation process.

Kingsdale's Take

Soliciting dealer arrangements in proxy fights are not used for the altruistic purpose of increasing shareholder participation in a democratic process; they are used as an entrenchment tactic for directors under fire. The only way to ensure the integrity of a shareholder voting system that presently lacks transparency is to ban soliciting dealer arrangements within the context of proxy fights in their entirety.

The broker/client relationship is based on trust and that trust should not be manipulated by offering skewed incentives. Shareholder outreach should be exclusively the purview of entities that are transparent in their task to contact and convince proxy voters, and that lack a "special relationship" with an investor that can be improperly exploited.

3 Our Advice

Are You Ready for Your Moment of Truth?

Why personal branding for directors can be your company's ace in the hole

Without a doubt, the rise of shareholder activism, populism, rapid availability of information, and legal and regulatory changes that have increased transparency, have served to place corporate boards under increased scrutiny.

Companies are no longer measured solely on what they produce and what value they have created. They are now evaluated by how they are governed – not only who their leaders are but how they lead.

Financial performance is now equal to risk management—having thought or not thought about things like a cyberattack from a foreign state or a tweet that could destroy millions of dollars of shareholder value in an instant – and the importance placed on issues like the environment, diversity, and shareholder engagement.

While companies have long understood that their brand is a valuable asset – perhaps the most valuable for those in the consumer goods or services industries – more would do well to recognize that the brand of their board, or more specifically their individual directors, matters and can make a big difference.

Directors represent the company at the highest level and, while shareholders may have invested in the business case, it is the people at the top who they will feel they have a connection to – or repulsion from. How directors conduct themselves sends a strong signal to shareholders about what a company deems important.

When we talk about a board's brand, we don't mean how it markets itself and the company, we mean the intangible capital it either builds with or withdraws from stakeholders – capital such as trust, credibility, integrity, and alignment with their interests. Perhaps the simplest way to get a sense of your board's brand is to ask, when you tell someone you are on the board of a certain company: Are you proud or embarrassed? What reaction do they have, especially if you are asking them to join your board or invest?

The fact is every business decision comes down to trust – not how much do you trust the numbers on the page and the plan you are seeing, but how much do you trust the people giving you those numbers and overseeing that plan.

A strong board brand can help build the corporate brand, increase shareholder value, and make the company more resistant to turmoil. It can serve as an antidote to unnecessary missteps and unwarranted criticism if people are willing to give your leaders the benefit of the doubt. You might have a world-class asset and a track record of strong returns, but when the spotlight comes on and you are under scrutiny, none of that will matter if people don't trust you.

Brand Reputation: Strength and Anchor

If you have ever been part of a company with a board made up of strong, credible people, you will no doubt have seen the benefits firsthand. It is easier to recruit and retain better people to serve both as directors and senior management, which in turn creates the preconditions for value creation: increased viability in the eyes of the market, internal cohesion, better productivity, and stronger relationships with key stakeholders.

But a director's concern for their own reputation may also negatively impact a company if they are hesitant to undo previous decisions that have proven to be faulty, instead deeming it better to be seen as willing to stay the course. When confronted with tough decisions, there is no doubt directors consider, even subconsciously, questions like: How would reversing the strategy I signed off on 18 months ago or firing the CEO we just hired reflect on me?

How to Build Your Brand as a Director

Build your knowledge and your brand will follow. Are you a director who waits until 24 hours before a set board meeting to read the materials provided? Do you only engage in meetings when called upon by the chair? Making sure you have internalized key aspects of the company you lead will go a long way to building your personal brand. For example, being able to explain the strategy in a few simple sentences; the company's positioning vs. peers; or things like its approach to compensation. Directors who are on top of their game tend to have the strongest personal brands, are relied on to engage with key stakeholders, and are called on when the company needs them the most.

Get out of the boardroom. The case for independent directors to get out and engage shareholders has been well-made in the last few years but we would extend that thinking to other stakeholders. When was the last time a director talked to a frontline employee who is actually operationalizing the plan, or to business partners, or met with customers, or engaged with the communities the company operates in? Not only will this help build your knowledge base and confidence, it will advertise you to key influencers and build personal capital with each that you can call on when needed.

Use all available channels. Too often investor-facing documents such as the management information circular, MD&A, and quarterly reports are prepared as routine documents by lawyers and bankers only asking what must be included from a legal and regulatory perspective and not what can be shared to communicate the board's shareholder-friendly philosophy. Often these documents complicate rather than simplify things for investors. Research has shown that if a piece of communication appears unnecessarily complex, the audience will assume you are trying to hide something. A clear, simple narrative as part of these documents can go a long way toward building credibility and trust.

HOT OR NOT?
BEING A DIRECTOR

With changing responsibilities and increased demands, has the prestige of sitting on a Canadian board diminished?

With the days of the old boys' club *somewhat* gone and the concept of clipping a retainer for little effort also dust in the wind, what impact has this new paradigm had on prospective directors and how does it realign their motivation and desire to serve? No doubt there is still cachet and notoriety that comes with being a director of an A-list company but let's be frank, that roster of jobs is limited.

What does it mean to be a director today versus a decade ago?

In short, the increased expectations of shareholders and demands of regulators mean more work, more effort, and more scrutiny for directors.

Director pay is continuously under the microscope and is often the first place upset shareholders look to criticize – despite the increased skill and effort required by directors. Between staying abreast of the macro- and microeconomic environments in which the business operates, ESG, risk management (cybersecurity), and actual shareholder engagement, the list of demands placed on directors continues to expand.

Directors are often retired executives and as such aren't necessarily operating in the day-to-day business environment anymore, requiring them to make a real effort to stay in the know. The expectation is also that directors reach into their own pockets to buy shares or subject themselves to criticism from shareholders and proxy advisors. This self-selects out many otherwise qualified directors who may not have the means to serve.

Against this backdrop, it is easy to understand why director recruitment has become such a challenge and why so many good candidates have become pessimistic towards the job. Who wants the job and how companies can effectively recruit directors while ensuring the talent pool they are picking from is robust – and not the bottom of the totem pole – can expose boards to further vulnerability.

In this emerging reality, shareholders should be challenged by asking: Don't you actually want to ensure those who represent you are effective and motivated, meaning they are properly incentivized and compensated?

We know, of course, that director compensation is rarely criticized when companies are performing. Somewhere in between there is a balance to be struck between economic and professional reward. As the saying goes, *if you pay peanuts...*

Here is what companies can do to recruit top directors:

01 Review your director compensation package annually and see how you stack up – is what you are offering fair?

02 Does your compensation package align directors with shareholder interests?

03 When interviewing directors, try to get to their motivation for why they want the job – if the first question is "What is the retainer?", you are likely in trouble. *(Plus they can look that up in your circular!)*

04 Understand what other interests and obligations a prospective director has. This is important because it speaks to time demands and dedication.

05 Seek out candidates who may be outside the norm. Not all directors need to be 60 years old or above. Consider the industry you are in and who may be more relevant. If outside the norm, then have a good explanation for shareholders as to why you made that choice. Scrutinize your skills matrix.

06 Ensure the directors and officers liability insurance offers the right coverage.

07 Seek input from shareholders – sometimes they have good ideas too.

08 Use recruiters – they are good at what they do for a reason.

09 Sell candidates on why being a part of your board should be of interest to them – make the situation compelling. Be able to clearly depict your strategy and value proposition. This is harder than you think.

10 Create a strong board culture. What does your board do outside of just board meetings? How do they treat each other in meetings? Are people respectful? Are materials provided in a timely fashion and are they relevant? Candidates who are electing to be board members want to be part of something positive. In the end, directors need to respect each other, and strong directors beget other strong directors.

Take a position. For key issues impacting your industry, it is easy to shy away from public comment, not wanting to expose yourself to alternate points of view or criticism. The fact is a company's key stakeholders are looking to you for leadership, especially in moments of controversy or crisis. You are judged not only on what you say but how and how quickly you say it. Directors should ask themselves: What conversations are happening that are relevant to our key stakeholders that I want to be part of? Where can I lead?

Put some skin in the game. A perennial shareholder issue is director alignment with those they represent. Directors who believe in the company they help oversee and have invested their own capital in (rather than simply taking fees in stock) are seen as personally invested in the success of the company and aligned with long-term shareholder interests.

Certainly, shareholders seek directors with industry experience and who understand the nuts and bolts of their company – that will never change. But in this era of increased activism and increased scrutiny, personal brand is increasingly important. It's never too late for you to start working on your brand.

THE CHANGING EXPECTATIONS OF BOARD REFRESHMENT

How long of a tenure is too long and what to do about it

Board refreshment may not be a top-of-mind priority in advance of a normal course annual meeting, but it's something that can't be ignored. Proxy advisors and institutional investors are placing increased scrutiny on tenure and have slightly different views on how long is too long for a director to sit on a board.

While proxy advisors have not yet developed voting policies that specifically penalize long-tenured directors, companies will have their ISS QualityScores negatively impacted if more than one-third of their board has a tenure of nine or more years.

In a proxy contest situation, board refreshment can become a major issue as directors with long tenures tend to be vulnerable targets for replacement by activists. Activists will argue that these directors should be largely held accountable for the sustained underperformance of the company and have been proven to have done nothing effective to turn the company around.

From the perspectives of both upholding best corporate governance practices and pre-empting potential activist attacks, board refreshment can no longer be a low priority item on the company's corporate governance checklist. Board refreshment

Board Refreshment Checklist

- **Establish tenure expectation when directors are added to the board. It can be hard when the expectations of a director don't line up with the expectations of the company.**
- **While there is no magic number, directors with tenures of over nine years should be considered for removal.**
- **It is important to consider the number of directors who have served together over a long period of time, with specific focus on CEO/Chair overlap.**
- **Consider skillsets and expertise that are missing when conducting board refreshment, including those needed in the future based on emerging issues and trends.**
- **Set diversity targets and prioritize towards meeting those targets.**
- **Pay careful attention to committee chair replacement. Have a succession plan for key committees, with the incumbent benefiting from the outgoing chair and a transition year of serving together.**

Overall, companies should conduct a regular assessment of board composition and have succession plans in place as well as a board refreshment policy. A refreshment policy not only ensures a proactive approach but also is viewed favourably by proxy advisors and shareholders.

can be challenging due to a limited talent pool and the need to balance a historic knowledge with a fresh approach. The circles many Canadian directors travel in are small and even the best search firms can only identify so many new candidates. In such cases, constructive activists may be a good source for qualified board candidates. Subject to the board's independent evaluation, given the deep understanding of the company's business and issues, the candidates proposed by constructive activists tend to be well-filtered and tailored to the company's situation.

COMPENSATION CONSIDERATION FOR EXECUTIVE ONBOARDING AND DEPARTURE

Plan ahead to pre-empt compensation concerns from shareholders

Increasingly, executive transition payments are coming to the attention of proxy advisors and shareholders given their one-time nature. In our role as a compensation advisor with governance expertise, we have observed that this scrutiny is often not considered in the front-end design of these payments nor in how they will be explained. Any and all one-time payments must be carefully explained, as proxy advisors and shareholders will analyze them to see if they are a good use of shareholder capital.

Based on our experience, the following features of an incoming CEO's compensation package will attract high levels of attention from proxy advisors:

- Additional pensionable service years for incoming executives
- Guaranteed bonuses in incoming CEO employment contracts
- Change-of-control provisions that are not double-triggered nor provide for protections that exceed the Canadian norm of double the cash salary and bonus
- Tax gross-ups for change-of-control or other elements of compensation

In order to avoid increased scrutiny from ISS and Glass Lewis, companies should carefully consider the efficacy of these elements before awarding them.

It is also important to highlight that, for an incoming CEO, any sign-on or make-whole payment will impact ISS' quantitative pay-for-performance tests and may have overhang effects for the next several years, given that ISS uses three-year averages for CEO compensation on at least one of their quantitative tests. For Glass Lewis, this situation extends to other NEOs as they evaluate both CEO and top-five NEO compensation.

For departing executives, it is important to avoid departure payments that are above and beyond what was previously agreed to and disclosed as part of the employment agreement. For payments that go beyond what was contractually agreed upon, it is important that adequate rationale be disclosed. Where possible, avoid pay-for-failure situations where departure payments are provided to an executive for their termination, especially in cases where shareholder returns were poor leading up to the departure event.

CEO Transition Best Practices	Things to Do	Things to Avoid
Sign-On Awards	• Multi-year (cliff or pro rata, minimum of 3 years) performance-vesting sign-on awards using measurable performance metrics, representing no more than 1 to 2 times annual equity grant	• Excessive cash sign-on (50%+ of salary) • Time-based vesting sign-on equity awards not tied to multi-year measurable performance-based metrics (e.g. relative TSR)
TDC Design	• Total Direct Compensation targeted at P50 of compensation peers • STIP using measurable scorecard • At least 50% of LTIP performance-based (e.g. 50% PSUs or more)	• Base pay significantly higher than predecessor • Guaranteed bonuses or equity payout • Total Direct Compensation targeted > P50 of compensation peers or significantly higher than predecessor
Make-Whole	• Bundle make-whole with sign-on awards and attach multi-year performance vesting metrics (total sign-on plus make-whole should not exceed 1 to 2 times annual equity grant)	• Bonuses or equity granted for sake of making up awards given up at previous employer • Time-based equity award (e.g. RSUs)
Change-in-Control	• Double-triggered change-in-control provisions with a severance multiple not exceeding 2 times cash salary and bonus	• Incremental payments exceeding 2 times cash salary and bonus, and triggered without actual dismissal, or voluntary resignation without constructive dismissal
Other Perks	• Standard medical, retirement planning, parking, or DC pension contributions and similar benefits not in excess of $250,000	• Tax equalization or gross-ups • Excessive aircraft supplements • Out-of-ordinary supplemental income (e.g. excessive relocation expenses)
Pension	• Standard DC pension plan • DB pension plan with no additional pensionable service years from previous employer, based on standard 2% cash compensation (salary/achieved bonus)	• Make-whole additional pensionable service years • DB plan basis > 2% cash component x service years • DB plan early retirement without penalty • DB plan without absolute $ cap of annual benefits

PUTTING THE 'PLAN' BACK IN PLAN OF ARRANGEMENT

Part XV, section 192 of the *Canada Business Corporations Act (CBCA)* (dealing with fundamental changes to corporations) contains an incredibly flexible tool called Plans of Arrangement (POA). POAs have long been used as the common approach to achieve a friendly merger or acquisition, but section 192 contemplates a broad array of fundamental changes, including amalgamation of corporations, transfer of property between corporations, spin-outs of divisions or assets, distribution of assets to shareholders, go-private transactions, or liquidation events.

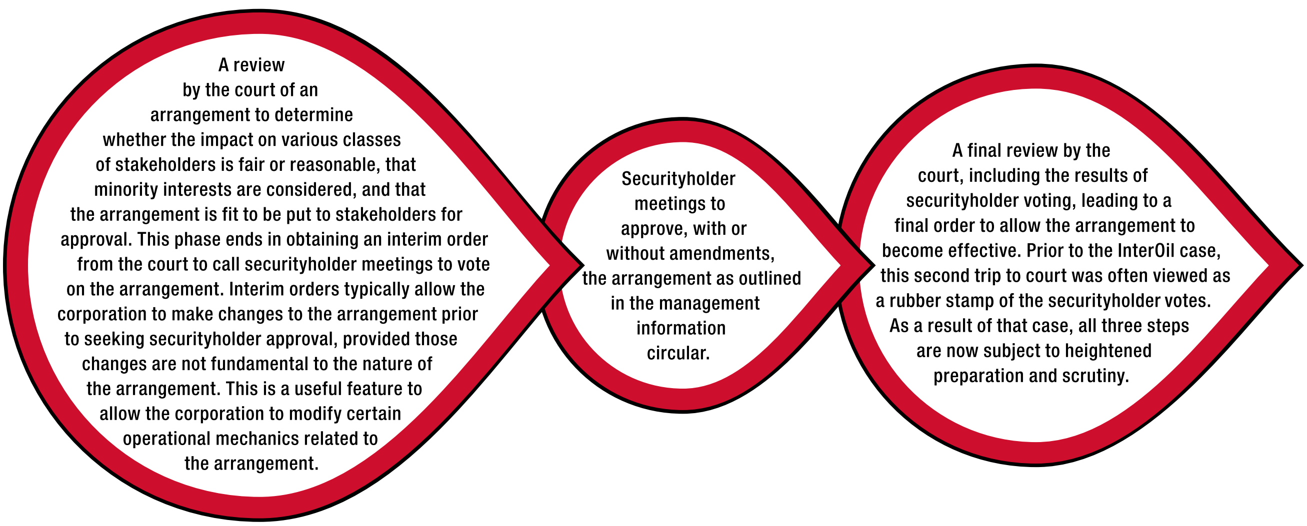
Given the flexibility of POAs, in the past few years, Kingsdale has seen an increase in the creativity and complexity of arrangements as issuers and their counsel seek to engineer the desired outcome while managing the risk of completing the arrangement.

While we have seen – and been part of – a number of precedent–setting arrangements, we have noticed very little, if any, comprehensive research and discussion on this topic. We think there are a number of innovations, trends, and pitfalls issuers and advisors should be aware of.

POAs have long been seen to offer a corporation significant flexibility to rearrange its affairs and balance sheet. In recent years, the use has been extended to incent stakeholder support or to hedge the risks of stakeholder resistance. We have also seen creative approaches to dealing with market trading during a time of reorganization.

POA Basics

For the uninitiated, a POA is effectively a court-supervised fundamental change to a corporation that involves three main steps prior to implementing the contemplated change:



Settlement of the arrangement is often thought of as just the precursor to the closing party, but in reality, it can be fraught with problems if not planned for and structured into the arrangement from the outset. Most of our observations involve one or more operational considerations that materialize at the settlement of the arrangement.

POA Innovations: The Use of Sweeteners

Securityholders generally need an incentive to change the status quo. Shareholders are typically offered a premium over the market value of their shares in M&A transactions other than mergers of equals. Likewise, creditors are often offered incentives to alter credit arrangements. POAs are one of several tools available to restructure debt for companies that took on debt to fund growth through M&A and find the debt burden difficult to support during a down cycle.

"Consent consideration" is the term used for a sweetener that is offered to creditors as an incentive to agree to alter the credit arrangements. In the past, a consent consideration was offered to all creditors if the change was approved by the required majority of securityholders.

In 2016, Sherritt International decided that it only wanted to pay the consent consideration to those creditors that supported its arrangement to extend the term of notes with an early vote for the arrangement resolution. Further, the early consent consideration offered noteholders a choice between cash and warrants. Simple enough? Not really – which brings us to the next innovation.

Linking Votes with Corporate Actions

For the Sherritt arrangement to work, they first needed to know the identity of every noteholder and how they voted, then a way to deliver the consent consideration to the right noteholders. The challenge was twofold: First, the proxy voting system in North America uses an omnibus model and doesn't record all the underlying beneficial owner votes – in effect, it aggregates votes at the custodial level. Second, delivering securities to beneficial owners is a corporate action normally processed through the central securities depositories, which do not interface with the voting systems.

The solution was to use the existing functionality of the CDSX system of the Canadian Depository for Securities (CDS) in an entirely new way so that the consent consideration elections were tied to the consents (votes) and supported the consent, the election, and the settlement processes.

Since the Sherritt arrangement, Kingsdale has seen an increase in the number and complexity of balance sheet reorganizations or recapitalizations requiring that votes be linked with corporate actions in order to support the myriad of possible capital structure changes: new capital raises, old debt for new, debt for equity, partial debt paydowns, one type of debt for another, combining debt series, and combining equity classes.

The U.S.'s central securities depository, Depository Trust Company (DTC), has a similar functionality to CDS through its Automated Tender Offer Program (ATOP) system and it is SEC-approved to support consent solicitation processing. However, it cannot be used directly for POAs or the U.S.-equivalent Schemes of Arrangement because DTC's key ATOP system has not been SEC-approved for processing votes. The distinction may seem subtle, as is often the case with regulation. Where securities held in DTC are subject to an event with both votes and elections, it requires a more manual approach using master proxies and necessitates a detailed reconciliation between the votes and elections cast during the event.

With the growing use of court-approved fundamental change arrangements, Kingsdale expects that it is only a matter of time before an issuer or industry group approaches the SEC to use ATOP to support early consent elections contemplated in POAs and Schemes of Arrangement. Such approval would provide significant additional capability for handling more complex arrangements requiring a link to a vote and involving securities held in DTC.

When a Record Date Isn't a Record Date

Securityholder meetings under a POA require record dates to determine who may participate in the business of the meeting. Where POAs are used to restructure credit obligations or to recapitalize, it is important to be aware of the reality of market trading in securities, even if that is not directly germane to the restructuring itself. In years past, when discussing a contemplated arrangement with issuers, it was not uncommon to hear statements like "Our bonds don't trade a lot," to which we would respond, "Yes, but they will as soon as this becomes public."

There is an entire investment community that trades in credit-driven events. Record date still determines who holds the voting rights and other entitlements, but the market convention is that positions can be traded "with rights attached".

Kingsdale has even seen supporting or sponsoring creditors to a POA sell off their position if the market dynamics change. By way of example, we have seen a 20% creditor buy their way post-record date and becoming an 80% holding creditor during a POA. The last thing an issuer needs is votes stranded by post-record date sellers or the inability to determine the settlement date entitlements of post-record date buyers.

It is important that an issuer have the expertise available to it on a credit-driven event to plan for and design a process in support of the arrangement, and to contemplate and track post-record date trading so that both the voting and entitlement legs are optimized.

Hedging the Risk of Approval

Under a POA, various classes of securityholders impacted by the contemplated changes are required to provide approval. Where the POA impacts multiple classes of securityholders, there is a risk that one class opposes the change while others support it, causing the entire arrangement to fail. Careful design of the arrangement can provide a level of risk mitigation without compromising the rights of underlying securityholders.

For example, in the Lowes–RONA arrangement where Lowes would acquire all of both share classes, both common and preferred shareholders were asked to vote. However, closing the arrangement was not conditional on preferred shareholder approval. The arrangement was structured such that if common shareholders approved the arrangement, RONA would be acquired by Lowes and Lowes would assume all of the obligations towards preferred shareholders.

Common shareholders overwhelmingly supported the arrangement but preferred shareholders voted against. Subsequent to closing the primary arrangement, Lowes negotiated an improved offer for preferred shareholders and completed a second-stage transaction to directly acquire the preferred shares.

In credit-driven arrangements, the risk of failing to obtain creditor approval can be pivotal, with bankruptcy proceedings the only remaining course of action. Concordia International Corp.'s 2018 recapitalization arrangement took a precedent-setting approach, with the arrangement contemplating votes counted under the CBCA POA to also be effective for any contingent and subsequent *Canadian Companies' Creditors Arrangement Act (CCAA)* or U.S. Chapter 11 Bankruptcy Code proceedings. While elegant from the perspective of a creditor-supported structure, the arrangement introduced a high degree of complexity to both the disclosure and operational processes required to support it.

It's a Matter of Class

Under a POA, a class is a group of stakeholders who share a common impact from the contemplated change. Once again, the flexibility of POAs can be seen in this crucial aspect of the arrangement design. Some groupings of stakeholders into a class seem obvious – like shareholders versus creditors, common shareholders versus preferred shareholders, or secured creditors versus unsecured. Other grouping decisions may be less obvious. For example, do notes in multiple series with a similar credit standing but significantly different liquidity belong in the same class? What about notes and loans?

In practical terms, defining the class is usually relatively straightforward for counsel to determine but may have operational considerations that need to be solved – particularly where the participants in the class operate in different parts of the market. The Concordia arrangement noted earlier provides another case where the secured and unsecured creditor classes both included notes and loans. Notes are exchange-traded and settle electronically in DTC, whereas loans are traded over the counter and settle manually through a loan agent. Accordingly, the notes and loans followed entirely separate processes for voting, electing, and settling of entitlements, yet were aggregated for the purposes of determining the approval of the arrangement.

Kingsdale's Take

The key word in POA is *plan*. When contemplating any fundamental change to your corporation, surround yourself with great advisors at the planning stage.

Choose financial advisors who not only know how to optimize the valuations but also have solid working relationships with the larger market players.

Choose counsel with a track record and reputation for handling the most complex structures, even if you think yours is simple.

Choose a proxy advisor that has bench strength in communications, proxy solicitation, and corporate actions, and a track record for getting things done – you never know what turn an arrangement could take.

Being successful in a complex POA is not simply about getting votes. It is equally important that your advisor understand and have strong working relationships with domestic and foreign securities depositories and the back office corporate actions contacts at these depositories, as well as the transfer agents and registrars. When dealing with a unique arrangement, it is not uncommon for some industry participants to be unable to deliver what is required. As such, forethought should be given as to who on your team could step up and fill that gap and involve them at the planning stage to maximize the success of your POA.

Being the best in our field means reliably delivering the results our clients want – no matter the challenge.

Our track record of success is backed by our unparallelled expertise and culture of 24/7 client service.

Regardless of what your needs are — from governance advisory to compensation advisory to strategic communications to shareholder identification to depositary to full proxy solicitation for any type of voting matter — Kingsdale has the complete solution for you.

There's a reason why we're engaged on more proxy contests than all others combined: We win.

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