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BY EMAIL

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OSC Staff Notice 54-701 – Regulatory Developments Regarding Shareholder Democracy Issues

Thank you for the opportunity to provide comments to the Ontario Securities Commission (the "OSC") in response to OSC Staff Notice 54-701 – Regulatory Developments Regarding Shareholder Democracy Issues (the "Staff Notice").

As a general comment, we believe there are many areas of corporate governance that do not lend themselves to regulation for several reasons. First, regulation is typically a blunt instrument that does not take into account the particular circumstances of a sector or issuer. Second, governance practices that are appropriate for larger issuers are not necessarily workable for Canada's small and medium sized issuers. Finally, in order for regulation to be effective, it must be coupled with effective enforcement. We question whether the enforcement resources of Canadian securities regulators should be devoted to policing the corporate governance practices of Canadian issuers.

Experience has shown that important changes in governance practices in Canada occur without regulation. The comply or disclose regime has been in place in Canada since 1995 (first under the TSX rules and now under National Policy 58-201 ("NP 58-201") and National Instrument 58-101 ("NI 58-101")). Today, the practices recommended by the Canadian Securities Regulators (the "CSA") in NP 58-201 are generally accepted as base line standards of governance. Where an issuer's practices diverge from what is recommended in NP 58-201, the issuer must explain to its investors the reason for the divergence. This is appropriate because, in most cases, it is the investors, rather than the securities regulators who should decide whether the governance practices adopted by the issuer are appropriate.

In addition, institutional and retail investors in Canada have demonstrated their influence over the governance practices of the issuers in which they invest. Legislation was not necessary in order make the separation of positions of the CEO and Chair standard practice among larger issuers in Canada. The same applies to the movement away from granting stock options to directors. Most recently, say on pay has been adopted by a number of issuers as a result of investor initiative in putting the issue forward as a proposal.

Slate voting and majority voting for uncontested director elections

Suggested Approach Under Canadian Securities Laws

In our view, it is difficult to make the argument that shareholders should not be entitled to express their views on each individual put forward for election to the board of directors. Director elections are, however, a matter of corporate law and accordingly, there are only limited options open to securities regulators in addressing the majority voting issue. In our view, there are certain actions that the CSA can and should take in connection with majority voting through amendments to NP 58-201 and NP 58-101. As an aside, we note that it is not really correct to refer to our current system as "plurality voting" in the case of uncontested director elections. It is not a matter of the directors with the most votes cast in their favour being elected (as suggested by the term "plurality voting"). Instead, the number of candidates put forward is the same as the number required to be elected and each candidate requires only one vote in his or her favour in order to be elected (since our system does not allow for votes against directors).

We note that there are three elements necessary in order for majority voting to be effective. First, investors must be able to cast their votes in respect of each nominee individually, rather than voting for a slate. Slate voting has been almost universally used until recently, but it is not a legal requirement. It is merely a convention adopted by most issuers (whether for efficiency at the meeting or in order to protect individual directors from embarrassment). Second, if more than a specified percentage of votes are withheld from a director, there must be some repercussion. Often, for example, if a majority of votes is withheld, the issuer's policy may require that the director offer his or her resignation. Finally, the percentage of votes withheld must be disclosed. Without the prospect of disclosure (and the resulting embarrassment), the concern is that issuers and directors will take the issue less seriously.

On the first of these issues, it would be appropriate for the CSA to recommend as a matter of good governance practice (through amendments to NP 58-201 and NI 58-101), that candidates be put forward individually for a vote at shareholder meetings. Similarly, the CSA should require issuers to adopt and disclose a policy on the action that the director and the board will take if a director receives more "withhold" votes than "for" votes. We believe that the board must retain the discretion about whether to accept a resignation offered by a director in that position, governed as always by their fiduciary duty. We also believe that all issuers should be required to disclose the percentage of votes cast for and withheld from each director. The current requirement under National Instrument 51-201 is

that this disclosure is required only if a ballot is taken. Since virtually all votes are cast by way of proxy, where no ballot is taken, the disclosure of how the proxies were marked would serve the same purpose.

Issues Under Corporate Law

It would be possible for the corporate law to be amended to provide either that directors from whom a majority of votes are withheld are not elected at all or that they are automatically removed from the board following the election. Either could be workable, so long as a quorum of directors remains in office. In both cases, a number of consequential changes to the statute would also be required.

In either case, if a majority of votes are withheld from enough directors, it is possible that a quorum of directors would no longer be in office and a new shareholder meeting would have to be held. Until that time, no business could be transacted. It may be possible to address this issue by having directors with the fewest votes withheld remain on the board in order to preserve the quorum, but this would become quite complex. As discussed above, a concept of "holding over" outgoing directors could also be introduced, but this approach also presents a number of problems. A more practical approach might be to allow the directors from whom a majority of votes were withheld to serve as directors until their replacements could be appointed, with a requirement that replacements must be appointed within a prescribed period of time. However, where the shareholders have not even approved of a quorum of directors, it would seem perverse for those individuals to be selecting their successors. This leads us back around for a need for a new shareholder meeting, with the associated costs, if a majority of votes were withheld from a quorum of the directors. In the meantime, the corporation would be paralyzed since the board would not have the authority to transact business.

Mandated shareholder advisory votes on executive compensation

We are not persuaded that shareholder advisory votes on executive compensation should be mandated. This practice is already being introduced at Canadian shareholder meetings as a result of shareholder pressure and the number of issuers adopting say on pay is growing. Moreover, we question whether say on pay is an effective tool for shareholders in any event, particularly when compared with majority voting. Shareholders who have the right to withhold votes from members of the compensation committee (or the entire board) arguably do not also need the additional tool of an advisory vote on compensation. The real contribution that will be made by say on pay will be in promoting engagement between shareholders and issuers for two reasons. First, issuers will be anxious to avoid a significant no vote and will therefore be inclined to discuss their compensation practices with their investors. Second, if an issuer receives a significant no vote, it will be able to understand the reason for that outcome only by reaching out to its shareholders. Say on pay may also have the result of "depersonalizing" shareholder objections to compensation

practices. Rather than withholding votes from members of the compensation or the board, they are able to express their views (albeit in a limited way) through the say on pay vote.

Notwithstanding our reservations about the utility of an advisory vote on compensation, we acknowledge that it has become a requirement in many other jurisdictions. Given the success we have enjoyed in Canada with the comply or disclose regime, we would recommend that the CSA limit its involvement in this area to amendments to NP 58-201 and NI 58-101, ultimately leaving the issue of whether an advisory vote is on the shareholder meeting agenda as a matter between the issuer and its investors.

Effectiveness of proxy voting system

We have concerns about the reliability and transparency of the proxy voting system in Canada. Last fall we released as a discussion draft *The Quality of the Shareholder Vote in Canada*, which describes the research we have done in this area. A copy of that paper is attached to this letter. We would like to highlight a number of points which are discussed in that paper:

It is apparent that, Canadian securities regulators are dependent for information about the way in which the proxy voting system operates on the third party service providers who have a vested interest in the existing business model and in any changes to that model. We believe that the securities regulators should establish a task force of individuals who are knowledgeable about the system, but who do not have any current stake in the system (whether as service providers or advisors to those service providers). The mandate of the task force should be to conduct a detailed examination of the operation of the proxy voting system and then determine whether the proxy voting system is effective. The task force should produce detailed recommendations about steps that need to be taken to remedy any deficiencies in the system and should, to the extent possible, set timelines for progress in that regard.

In addition, we do not believe that Canadian regulators are sufficiently engaged in regulation or oversight of the proxy voting system. Important aspects of the system are not subject to any regulation and those that are, are not subject to compliance reviews. Issuers and investors are often not aware of problems that occur in connection with any particular shareholder vote and, to the extent that they are aware of any problem, they find it difficult if not impossible to resolve the problem satisfactorily. The integrity of the proxy voting system is clearly within the purposes of the *Securities Act* (Ontario), which includes "fostering fair and efficient capital markets and confidence in capital markets". For the OSC to leave to the private sector, responsibility for fixing the serious problems with the proxy voting system is both impractical and an abdication of an important aspect of the OSC's mandate.

Finally, there are three specific problems that we believe could be examined as discrete issues by securities regulators in the short term. The first is the problem of certain

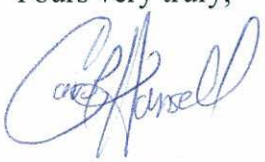
intermediaries sending unreconciled records into proxy system, thereby giving rise to the opportunity for multiple voting of the positions in shares held by the intermediary. This issue has been on the radar screen of Canadian securities regulators for many years, but no action has been taken. While issues remain in the United States, much more progress on this issue has been made by intermediaries there.

Second, we believe that the OBO/NOBO system should be re-examined. Canada and the United States are alone in having adopted this system, which may contribute to the complexity and lack of transparency in the proxy voting system. Moreover, the limitations on how OBOs are able to provide voting instructions are increasingly being extended to NOBOs, as evidenced by the amendments to National Instrument 54-101 recently proposed by the CSA. We see no reason that NOBOs should be subject to the same restrictions to which OBOs have agreed in exchange for not having their identity disclosed to the issuer.

Finally, we are concerned that if the phenomena of empty voting, hidden voting and negative voting were significant issues in any shareholder vote, those issues might be worthy of regulatory consideration. However, disclosure rules in Canada do not give us sufficient information about the extent to which derivative instruments are being used to influence a shareholder vote without exposing the holder to that instrument to the changes in value of the issuer. We believe that Canadian securities regulators should reconsider our insider reporting threshold (which is unusually high in comparison to almost every other jurisdiction) and in that regard require insiders to disclose all of their interests in the issuer, including those held through derivative instruments.

We thank you again for the opportunity to provide you with our views on these issues. I would be happy to discuss these matters further at your conveniences.

Yours very truly,



Carol Hansell

Enclosure

The Quality of the Shareholder Vote in Canada

Discussion Paper
October 22, 2010

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DAVIES WARD PHILLIPS & VINEBERG LLP

The Quality of the Shareholder Vote in Canada

TABLE OF CONTENTS

EXECUTIVE SUMMARY

Reason for the Paper

As a firm, we have extensive experience with shareholder meetings. Some of these meetings are routine, others involve proxy battles, the approval of important transactions or votes on governance matters such as shareholder rights plans or stock option plans. Together with our clients, we have encountered a variety of obstacles in making sure that votes are cast and counted at the meeting in question. We know others have had similar experiences. As a result, we have become concerned with the quality of the shareholder vote in Canada.

Because the results of shareholder meetings are important to our clients and to the capital markets generally, we decided as a firm to devote the time and resources necessary to understand the issues that might compromise the integrity of those results.[1] Our intention was to then engage in discussions with others who share our interest in the quality of the shareholder vote with a view to improving the system.

The first thing we discovered was that very few people understand how the proxy voting system works from end to end. Recognizing that without a common understanding of the system itself, the capital markets community would not be in a position to identify and resolve the problems that prevent that system from being effective, we took a step back. We decided to first work to bring together the information necessary to establish that common understanding.

Following 16 months of research and discussions, we have produced a paper that describes the history, mechanics and policy issues relevant to the proxy voting system. For aspects of the system in which we are not directly involved, we have asked for the assistance of organizations integral to the operation of the system. With very few exceptions, those organizations not only answered our questions, but provided us with further information that they felt would be relevant to this project. To the extent that interested parties have further information that would improve the discussion in this paper, we hope that they will share it with us so that everyone can benefit from the common base of knowledge.

We are releasing the paper initially as a discussion paper with the hope that those with an interest in the integrity of the proxy voting system will take the time to read it and provide us with their thoughts. We have offered some suggestions for next steps on which we also invite comment. Based on the further comments we receive, we will post updated versions from time to time and will ultimately produce a final paper.

This discussion paper is posted on www.shareholdervoting.com. We invite all comments either directly to the authors of the paper or by sending us an email at shareholdervoting@dwpv.com.

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[1] Researching and writing this paper was a project undertaken by Davies Ward Phillips & Vineberg LLP and not on behalf of any client or other party. We received extensive support from a number of individuals and firms who are connected to the proxy voting system and without whose assistance this paper would not have been possible. Since some would prefer not to be named, we have thanked everyone privately. The views expressed in this paper are our own.

Elements of an Effective System

In our view, an effective proxy voting system must satisfy at least the following five criteria:

- investors must be in a position to make an informed decision about how to vote or how to direct that their votes be exercised and must therefore have adequate time to review the proxy materials;
- investors must be able to cast their votes or provide voting instructions in accordance with rules that are clearly explained, impartially applied and practical for investors to follow;
- if an investor casts a vote or provides voting instructions in accordance with the established rules, that vote must be given its full weight at the shareholder meeting in question;
- votes attached to the securities of an issuer should be cast by those investors who hold the economic interest associated with those securities; and
- there must be sufficient transparency in the voting system so that both issuers and investors are confident that the system works.

Issues with design and operation of the proxy voting system create a reasonable apprehension that the system may not consistently meet these criteria. These issues, combined with public examples of the system failing in each of these areas, have compromised confidence in the effectiveness of the proxy voting system among many of its stakeholders.

Features of the System

The following is a summary of the features of the proxy voting system that are relevant to the discussion in this paper:

- ***Investors Hold Their Interest Indirectly –*** Most investors (both retail and institutional) hold their interest in shares indirectly, through one or more intermediaries. The issuer therefore has no direct relationship with most of its investors.
- ***Shares Held in Fungible Bulk –*** Each intermediary holds shares in "fungible bulk". "Fungible" means that each share is identical and so it does not matter to the investor whether it has invested in one share as opposed to another share. "Bulk" means that the intermediary has a position in the aggregate of all the shares in which it holds an interest for its clients.
- ***OBO Status –*** Investors have the right under Canadian securities law to elect *not* to allow their intermediaries to disclose their identity to the issuer. The investors who do so are referred to as "OBOs" (Objecting Beneficial Owners). Those who allow their intermediaries to disclose their identity to the issuer are "NOBOs" (Non-Objecting Beneficial Owners).
- ***Unreconciled Records –*** The records submitted by intermediaries in connection with shareholder meetings are often not reconciled to eliminate positions relating to shares that have been loaned or should otherwise not be available to be voted.
- ***System is Operated by Third-Party Service Providers –*** The machinery of the proxy voting system is operated by third-party service providers. Transfer agents and proxy solicitors act

on behalf of issuers, proxy agents act on behalf of intermediaries and proxy advisors act on behalf of investors.

- ***System is Complicated –*** The proxy voting system involves a number of different parties and at least as many different systems and databases. It is susceptible to administrative and technological errors.
- ***System is Not Transparent –*** How communications flow between issuers and investors is not visible to any of them. The lack of transparency means that when an error occurs, it will often not be discovered – and therefore will not be rectified.
- ***Vote Confirmation Not Provided –*** The proxy voting system, as it currently operates in Canada, does not provide to an investor confirmation that the investor's voting instructions were translated into a vote that was counted at the shareholder meeting. Vote confirmation is possible in concept, but requires cooperation from everyone through whose hands the communications between the issuer and investors pass. Alternatively, one provider would need to control each of the steps of the communication process required to provide vote confirmation.
- ***Dominant Role of Broadridge –*** The proxy agent for almost all of the intermediaries in Canada is Broadridge. Accordingly, Broadridge is responsible for all of the mailings and tabulation of voting instructions for a very significant percentage of investors in every public company in Canada. Proxy agents are not regulated in Canada.
- ***Votes May Be Cast by Persons with No Economic Interest in the Issuer –*** Votes may be cast by persons who have no economic interest in the issuer. This may occur because the person sold its interest prior to the meeting, or as a result of derivative instruments that allow a person to acquire a right to vote with no economic exposure to the share being voted.
- ***Power of Proxy Advisory Firms –*** Many institutional investors use the research services and proxy voting platforms offered by proxy advisory firms. As a result, proxy advisory firms have the ability to influence the way in which their clients (typically institutional investors) vote.
- ***Regulatory Engagement –*** The proxy voting system is regulated primarily under securities law. That regulation ends when investors give their voting instructions to their intermediaries. How the votes are tabulated and proxies are cast is completely unregulated. Moreover, securities regulators do not monitor compliance with those aspects of the system that they do regulate.

Key Issues That Need to Be Addressed

The problems with the proxy voting system are so layered and complex that, in our view, a number of issues must be addressed before effective solutions can be proposed. The issues that we have identified as being the most immediate are set out below.

- ***Access to Information –*** There is not enough information available about the proxy voting system to allow an independent party to either prove that systemic problems exist or provide the confidence that they do not. Most of the information about the operation and effectiveness of the system resides with third-party service providers (transfer agents, proxy agents, proxy advisors and proxy solicitors) who have a great deal invested in the system and whose business interests would be affected by any change in the system. We hope this paper will contribute to a better understanding of the issues among issuers and investors. However, a more comprehensive audit of the system must be conducted by a task force of subject matter experts appointed by the government or by securities regulators.
- ***Movement Away from Paper-Based System –*** Some of the problems in the proxy voting system will be eliminated when issuers are no longer obligated to provide hard copies of their proxy materials to their investors. There will always be some investors who prefer paper versions of the materials, but there is a point at which the cost to the issuer and the mechanical complications outweigh the importance of providing the materials in the medium of choice to the investor. Canadian regulators need to do to more to encourage the transition away from paper-based materials. Notice-and-access is a step in this direction, but the recent proposals by the CSA are only a first – and quite tentative – step towards a true paperless system.
- ***Revisiting the Commitment to the OBO Concept –*** One of the hallmarks of the Canadian (and U.S.) proxy voting system is that investors may elect to conceal their identity from the issuer (the OBO/NOBO system). The fact that issuers cannot communicate directly with many (today almost half) of their investors makes the communication process much more complicated.
- ***Problems Created by Intermediary Files That Are Not Reconciled for the Purpose of Proxy Voting –*** Intermediaries (brokers, banks, custodians) are required to create a list of their clients who are entitled to vote at a shareholder meeting, together with the number of shares held by those clients. However, those lists are often "unreconciled". They have not been adjusted to eliminate, for example, shares that have been loaned. The loaned shares will therefore still appear on the list prepared by the lender's intermediary for voting purposes, and will appear on the list prepared by the borrower's intermediary for voting purposes. As a result, the vote attaching to a single share may be voted more than once.
- ***Issues Related to Broadridge's Place in the Market*** – Almost all of the intermediaries in Canada have outsourced their responsibilities in connection with communications between issuers and investors to Broadridge. Broadridge has played a leading role in improving and streamlining the proxy voting system in Canada. However, Broadridge is not subject to regulation in Canada and neither issuers nor investors have a line of sight into how Broadridge has handled the voting instructions from investors in connection with any particular meeting.

- ***Deciding Whether Empty Voting Matters and How to Deal With It –*** There is no question that empty voting occurs. The problem is that there is no way to determine how extensive it is. If it has no real impact on the outcome of a shareholder vote, perhaps there is no reason to focus on it. If, however, it were shown that it happens more than rarely and could have a material impact on the results of a shareholder vote, then the basis of shareholder decision making may come into question.
- ***Power of the Proxy Advisory Firms –*** Many institutional investors rely heavily on the recommendations of proxy advisory firms in deciding how to vote their proxies. Some issuers feel that the degree of de facto reliance gives proxy advisory firms the power essentially to dictate governance practices. Others are concerned that the proxy advisors do not understand issues specific to that issuer or even that they get some things wrong in their analysis. Finally, some are concerned with conflicts of interest where a proxy advisor both sells governance consulting services to issuers and provides voting recommendations to investors. A better understanding of the role and methods of proxy advisory firms is needed. In addition, issuers need a forum in which to articulate their concerns - a forum that would be capable of providing responses and solutions that alleviate the current concerns.
- ***Responsibilities of Investors –*** Do investors have any responsibilities to the issuers in which they invest or to the capital markets generally? Should they be expected to vote? If so, how do they reconcile securities lending with their proxy voting policies? These issues are receiving increased focus and in some cases affect other issues addressed in the paper. Institutional investors should engage actively in the issues facing the proxy voting system and the role that they play.
- ***Engagement of Securities Regulators –*** Securities regulators must acknowledge the importance of an effective and reliable proxy voting system. They should be championing a comprehensive review of the system and be prepared to regulate aspects of the system in which they have not been involved.

THE QUALITY OF THE SHAREHOLDER VOTE IN CANADA

The proxy voting system in Canada is sufficiently flawed in its design and operation to raise legitimate questions about the quality of the shareholder vote in Canadian public companies. A high quality vote is one that accurately reflects the informed views of investors who wished to vote. For this to be the case, investors must receive their proxy materials in a timely manner, they must be able to access the voting machinery and each vote must be given its full weight. In addition, voting decisions must be made by persons who hold the economic interest in the shares being voted.

Weaknesses and deficiencies in the design and operation of the proxy voting system have the ability to compromise the quality of the shareholder vote. They can, for example, result in investors not receiving proxy materials. They can also result in votes that have been cast not being counted for any one of a number of reasons. Votes could be lost, pro-rated or rejected and neither the issuer nor the investor will ever know if this has occurred. Complicating matters even further, a single share could be voted more than once – each time by a different person. Public examples of these issues makes this more than theoretical.

The complexity of the proxy voting system in Canada often makes it difficult to isolate the source of the problems. This complexity stems in part from the fact that issuers are prevented from communicating directly with many of their investors. Issuers provide proxy materials to their investors, and investors send their votes back to the issuer through a waterfall of agents and intermediaries. Human and technological errors, regulatory gaps and opportunities for manipulation are not sufficiently mitigated by control systems to assure issuers or investors that communications are flowing unrestricted between the issuer and investors.

No one really knows how serious the problem is. Errors in the system are often caught when it is clear that a vote will be contentious because, in those cases, large blocks of shares are being tracked by proxy solicitation firms. For the overwhelming majority of meetings that are not contentious, however, management may decide not to incur the expense of hiring a third party to ensure that all shareholders have received a proxy and that all proxies entitled to be voted are being counted. When it comes to whether votes are being cast by the investor (as opposed to, for example, someone who is able to vote pursuant to a derivative instrument, but who has no economic interest in the share), there is currently no way to assess the magnitude of the problem.

Our purpose in writing this paper is to explain the proxy voting system in Canada in order to equip those with an interest in the quality of the vote in Canada to engage in a discussion of how to address the issues that could compromise the system. Where possible, we have offered our view of particular issues and suggested actions that should be taken. We are releasing this paper as a discussion paper in order to raise awareness of the issues and to allow us to continue to discuss those issues with various stakeholders. Our intention is to incorporate the comments we receive into a final paper.

For those who already understand the system well, it will suffice to read Part I of this paper, which introduces the problems, and Part VIII, which sets out threshold issues that we suggest need to be addressed in order to start moving forward to resolve some of the problems. For those

who require additional background, we hope that some or all of the remainder of the paper will be helpful.

In Part I, we set out the criteria against which we are evaluating the effectiveness of the proxy voting system and discuss some of the reasons why an effective proxy system is important. We also introduce the root causes that underlie the failures of the proxy voting system.

In Part II, we discuss how the capital markets evolved to the current system where most investors hold their interest in voting securities indirectly through intermediaries. This, of course, makes communication between the issuer and its investors difficult. We then go on to discuss the regulatory response to the broken communication chain.

In Part III, we explain how the indirect (or book-based) system works and how it relates to the legal relationships between issuers, registered investors and intermediaries.

It is important to understand who plays a role in the proxy voting system and so, in Part IV, we describe each of the participants in the system, and how they are regulated.

With that background, we describe in Parts V and VI how communications between issuers and investors flow with the assistance of certain securities regulatory requirements. Part V describes how proxy materials are delivered to investors and Part VI describes how votes are cast and counted.

In Part VII of this paper, we describe the impact of financial market innovation on the proxy voting system. In particular, we offer short primers on securities lending and empty voting so that the reader will be in a position to understand the issues for the proxy voting system that arise as a result of these phenomena.

Finally, in Part VIII, we identify some of the key issues that we believe need to be addressed in order to improve the quality of the shareholder vote in Canada. Resolution of these issues would not solve the problem, but it would eliminate many of the roadblocks to progress.

Throughout the paper, we explore potential solutions to the problems we identify. Success in addressing the problems would involve changes being made that would ensure a voting process that is both transparent and accountable, together with full disclosure about the nature of the interest in the issuer held by those who are making the voting decisions. Finding the path to implementing those changes will involve cooperation by the stakeholders and agreement on how these changes will be financed. Given the growing importance that market participants, and institutional investors in particular, attach to these issues, regulatory intervention may be inevitable.

Note to the Reader

Issuers come in a variety of forms – business corporations, partnerships, limited partnerships and trusts. We have based the discussion in this paper on the business corporation, which covers the majority of issuers in Canada. The issues discussed here may be the same or they may be different for other entities. Even with regard to business corporations, the rules applicable to a

corporation governed by one of the 14 Canadian corporate statutes may be different from the rules applicable to a corporation governed by another corporate statute.

For the most part, the corporate law provisions dealing with shareholder rights are very similar from one corporate statute to the next. This paper is based on the provisions of the *Canada Business Corporations Act* ("CBCA") unless otherwise indicated. For ease of readability, we refer to the corporate law or the corporate statutes, but primarily refer to the CBCA, with references to other statutes where we thought it was particularly important to highlight the similarities or differences among statutes. The securities law is a little less complicated. There are 13 sets of securities laws and 13 securities regulatory authorities, but in many areas, securities regulators have agreed on a common approach to certain issues in the form of national instruments. This includes most of the issues addressed in this paper. Where it is necessary to refer to securities laws other than national instruments, this paper refers to the securities laws of Ontario.

We use the term "investor" throughout the paper to refer to those people who have made the investment to acquire a share, whether or not they are registered shareholders. If they are not registered shareholders, we refer to them as "non-registered investors" or, where appropriate, as "OBOs" and "NOBOs". Definitions of these terms (and other terms used in this paper) can be found in the Glossary.

PART I - INTEGRITY OF THE PROXY VOTING SYSTEM IN CANADA

1 Why the Quality of the Vote Matters

1.1 Role of Shareholders in Corporate Decision Making

The efficiency and effectiveness of the capital markets depend on the willingness of investors to invest in public companies. Investor confidence depends in part on a belief that investors are being treated fairly when corporate decisions are being made.

Most corporate decisions are made by management and the board. The law tries to assure shareholders that those decisions are being made in the best interests of the issuer by imposing a legally enforceable standard of conduct on directors and officers referred to as their "fiduciary duty". When investors doubt that boards and management are acting in accordance with this standard of conduct, a lack of investor confidence can lead to a reluctance to invest in public companies.

The discipline imposed on decisions made by shareholders is quite different. Shareholders are not bound by a fiduciary duty to the issuer or to each other. They are entitled to cast their votes in their own self-interest. The underlying assumption, however, is that investors share a common interest – enhancement of the value of their investment. The marketplace therefore needs to be able to rely on the assumption that even though the investors are not a homogenous group and may even have different investment objectives, when presented with a decision, they will collectively vote for the course of action which they believe will create the greatest value.

Finally, the capital markets do best with certainty. If the results of a vote at a shareholder meeting accurately reflect the informed views of investors who wished to cast their votes, the proxy voting system is working effectively. Both issuers and investors can be confident in the quality of the vote and can make decisions grounded in certainty about the system. However, if shareholder decisions are understood to be affected by administrative error and unreconciled records or if the quality of those decisions is in question because of a lack of transparency and accountability in the proxy voting process, certainty about the decision-making process can be compromised. As the NYSE noted, the "…assurance of accurate and efficient proxy voting is the foundation of corporate democracy".[2]

[2] NYSE Information Memo 04-58, "Supervision of Proxy Activities and Over-voting" (5 November 2004).

1.2 How Investors Use the Vote

1.2.1 Institutional Investors

On average, institutional investors own over half of the shares of every company on the S&P/TSX 60 Index.[3] They devote considerable resources to the exercise of the voting power associated with those shares. Many develop and publish their own proxy voting guidelines, which form the basis of their voting decisions. As a result, issuers understand the voting intentions of many of their investors and are able to take the views of their investors into account, to the extent they consider appropriate, when making decisions and formulating recommendations. The resources devoted by institutional investors to their voting policies and decisions and the effect they can have on corporate behaviour underscores the importance of voting results that accurately reflect the views of investors.

Canadian institutional investors come together under the common umbrella of the Canadian Coalition for Good Governance ("CCGG"). This represents a much greater degree of cooperation among institutional investors than exists in many other jurisdictions around the world. The CCGG does not itself have a code for proxy voting and does not provide voting recommendations. It does, however, publish guidelines and position papers in a number of areas of corporate governance in consultation with its members and experts in the relevant field.[4] It meets with the chair of the board and other directors of a number of public companies annually on behalf of its members. The ability of the CCGG to deliver coordinated messages on behalf of its members (currently 41 members with over $1.4 trillion in assets under management) and to deliver input from issuers back to its members puts even greater force behind the voting strength of the institutional investors it represents.

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[3] According to Bloomberg, as of August 2010, the average holding by institutional investors in S&P/TSX 60 Index companies is 56.79%.

[4] The CCGG has issued Guidelines and Position Papers in the following areas: Building High Performance Boards; Executive Compensation; Board Engagement; Say on Pay; Majority Voting; Best Practices; Break Fees; Income Trust Governance and National Securities Regulator, online: <http://www.ccgg.ca/index.cfm?pagepath=Policies_Best_Practices/Policies_Principles&id=17581>.

Institutional investors have been responsible for a number of developments in Canadian corporate governance. The separation of the positions of CEO and chair,[5] the elimination of stock options for directors and the adoption of majority voting[6] have all come about as a result of investor pressure.[7] This is in contrast to other jurisdictions, where legislation or regulation is more typically required to introduce changes of this nature. Changes that are made as a result of investor pressure, rather than being mandated by government or securities regulators, provide greater flexibility for issuers and are typically adopted first by larger issuers, leaving smaller issuers more time to adapt.

1.2.2 Shareholder Proposals

Investors are able to influence corporate governance practices directly through shareholder proposals.[8] We discuss below the investors who have historically used the shareholder proposal as a tool to influence corporate behaviour. In the past, shareholder proposals have not typically been used by institutional investors, but we understand that some members of the CCGG may be prepared to consider shareholder proposals as a tool for encouraging more issuers to introduce majority voting and other "shareholder democracy" reforms in the next proxy season.

The amount of support that a proposal attracts can influence not just the issuer in respect of whom the proposal was made, but other issuers as well.

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5 The CCGG reports that 127 (55.70%) of the issuers in the S&P/TSX Composite Index have a chair who is independent of management. The CCGG notes further that many of those that do not have a chair who is independent of management have separated the roles of chair and CEO, but the chair is either related to the CEO or is a former executive of the issuer (current to September 7, 2010).

6 The CCGG reports that 125 (54.82%) of the issuers in the S&P/TSX Composite Index have disclosed their adoption of majority voting. Individual director elections have been adopted by 185 (81.14%) (current to September 7, 2010).

7 Say on pay was adopted in Canada as a result of proposals put forward by Meritas (see Section 1.2.2 below) but the CCGG worked closely with the issuer community to develop a policy and a form of resolution that was acceptable to the CCGG's members and to the issuer community. Carol Hansell of Davies Ward Phillips & Vineberg LLP advised the CCGG on this matter.

8 A shareholder proposal is a matter that is put on the agenda of a meeting of shareholders at the initiative of one or more shareholders, rather than the initiative of management. See Section 10.3.2 for a discussion of the legal framework relating to shareholder proposals. Under the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 [CBCA] and the *Business Corporations Act* (Ontario), R.S.O. 1990, c. B. 16 [OBCA], investors (beneficial owners) may make proposals but under other statutes, only registered shareholders may make proposals.

The "say on pay" proposal is an example.[9] In 2008 and again in 2009, the five largest Canadian banks and four other large issuers received say on pay proposals. The 2009 proposals were approved by shareholders of four of the banks. Once this occurred, the fifth bank[10] and each of the other issuers[11] agreed to adopt say on pay before their annual meetings were held and as a result, the proposal was withdrawn for those issues. In the 2010 proxy season, say on pay resolutions appeared on the agendas of meetings of not just those nine issuers, but on the agendas of a total of 28 Canadian issuers. More than 15 other issuers have committed to providing their shareholders with a say on pay vote in 2011.[12]

The say on pay experience illustrates how the effect of a proposal can reach beyond the issuers to whom the proposal was made or whose shareholders had an opportunity to vote on the proposal. In the context of this paper and its discussion of the quality of the shareholder vote in Canada (specifically here, the accuracy of the vote count), it is interesting to note that when the say on pay proposals succeeded in 2009, they received in some cases just barely more than the required 50 percent of votes cast to succeed. The resolution was passed by just 51.61 percent of the votes cast at the Bank of Nova Scotia meeting, for example, and by just 51.92 percent of the votes at the CIBC meeting.[13]

The subject matter of shareholder proposals changes from year to year and meets with different degrees of success. Say on pay was an example of a successful shareholder proposal campaign. In contrast, proposals have been made from time to time for issuers to put more than one nominee forward for each board seat and for issuers to limit the number of boards on which a director (particularly the CEO) may serve. Neither of these proposals has attracted significant support and neither proposition has been more broadly adopted by the issuer community.

However, issues that receive relatively little support in some years may attract greater shareholder support as circumstances change. "Pay equity" disclosure is an issue to watch in the next few years. In past years, proposals have been made to the Canadian banks for disclosure of what is referred to as the issuer's "equity ratio" (the ratio of total compensation of the CEO to that of the employees' average compensation and the ratio of the designated senior executives' total compensation to employees' average compensation). Although shareholder support was barely over 10 percent in some cases, it has been growing. Developments in the United States

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9 Say on pay is a shareholder advisory vote on a board's approach to executive compensation. A shareholder advisory vote is one that is not binding on the board of directors.

10 The Toronto Dominion Bank.

11 Sun Life Financial Inc., Potash Corporation of Saskatchewan, TMX Group Inc., and Toromont Industries Ltd.

12 See e.g. Janet McFarland, "TSX parent to allow 'say on pay'" *The Globe and Mail* (11 March 2009) B5. In the 2010 U.S. proxy season, three companies failed to obtain majority non-binding support for their executive pay packages: Motorola, Inc. (only 46% approval); Occidental Petroleum Corporation (only 47% approval); and KeyCorp (only 45% approval). This marks the first time that a U.S. company has failed to obtain majority approval for its say on pay ballot items.

13 The shareholders of the Bank of Montreal and the Royal Bank of Canada voted 53.60% and 54.40% respectively.

may cause support to grow further in Canada in coming years.[14] The *Dodd-Frank Act* requires the SEC to expand its requirements for proxy statements to include similar disclosure[15] and as a result, U.S. issuers will be required to provide such disclosure before long. This change may well lead to greater support for these proposals in Canada if they are made again.

Shareholder proposals are used by a variety of organizations. MÉDAC (a shareholder rights advocacy group based in Montreal[16]) submitted 29 shareholder proposals in 2010 (53 in 2009 and 97 in 2008)[17] on a variety of issues. Meritas (a faith-based mutual fund based in Kitchener, Ontario[18]) submitted 13 shareholder proposals in 2010 (10 in 2009 and seven in 2008).[19] Northwest & Ethical Investments L.P. (a joint venture co-owned by the Provincial Credit Union Centrals and by Desjardins Group) filed 13 proposals in 2010 (the first year in which it filed proposals).

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14 These proposals related to say on pay, nomination of more than one candidate for each director position, disclosure of ratios of executive compensation to average employee compensation, limits on the amount of variable executive compensation, limits on the number of directorships per director, gender parity for director nominees, and the independence of compensation committees and their advisors. Shareholder Proposal Database, online: SHARE <http://www.share.ca/shareholderdb/>.

15 The *Dodd–Frank Wall Street Reform and Consumer Protection Act*, Pub. L. No. 111-203, 124 Stat. 1376 (2010) [*Dodd-Frank Act*]. The Act refers to disclosure of the median total annual compensation of all employees other than the chief executive officer, the total annual compensation of the chief executive officer and the ratio of those two amounts.

16 The group was founded in 1995 by Yves Michaud with the defence of minority shareholders' rights as its mandate. It seeks to fulfill its mandate through advocacy on various issues of corporate governance.

17 These proposals related to say on pay, nomination of more than one candidate for each director position, disclosure of ratios of executive compensation to average employee compensation, limits on the amount of variable executive compensation, limits on the number of directorships per director, gender parity for director nominees, and the independence of compensation committees and their advisors. Shareholder Proposal Database, online: SHARE <http://www.share.ca/shareholderdb/>.

18 Launched in March 2001. It sells its funds across Canada through financial planners, advisers and banks. Meritas uses socially responsible investing (SRI) to help investors align their portfolios with their social, ethical, governance and environmental concerns. SRI also involves shareholder advocacy, including filing shareholder resolutions.

19 Shareholder Proposal Database, online: SHARE <http://www.share.ca/shareholderdb/> These proposals included the issuance of sustainability reports, suppler codes of conduct and participation in Carbon Disclosure Project. In 2006, Meritas engaged SHARE to help it launch its ultimately successful say on pay campaign.

Hedge funds also use shareholder proposals as a tool to influence issuer behaviours. There has been significant growth in activist hedge funds in both Canada and the United States.[20] Some begin with a dialogue with the board and management with respect to the changes they would like to see and then move to shareholder proposals or proxy contests if the board will not make the changes requested (as was the case in the TransAlta situation discussed below). Others move immediately to shareholder proposals and ultimately through to proxy contests.

In late 2007, TransAlta Corporation received a white paper from its largest shareholder, Luminus Management, LLC. That white paper recommended, among other things, that TransAlta fund a share buyback program by issuing $2 billion of new debt. TransAlta's board responded that this would more than double the current debt load and would result in TransAlta falling to a below investment grade credit rating. Luminus responded with four shareholder proposals, including the nomination of four directors at TransAlta's 2008 annual meeting. Luminus and TransAlta ultimately reached an agreement on actions to take in order to enhance the company's long-term potential and the proposals were withdrawn.

1.3 Business Transacted at Shareholder Meetings

Historically, the decisions made by shareholders at annual meetings were confined to the election of directors and the appointment of auditors. For most issuers, neither of these items has been particularly controversial. More recently annual meetings have become much more meaningful vehicles for investors to express their views to the issuers in which they have invested. In many of these cases, the percentage of votes cast for and against (or votes withheld) can deliver a meaningful message. This is the case with shareholder proposals and majority voting, for example. However, the meaning behind that message is only clear if there is confidence in the accuracy of the results.

In other cases, the issue is not the message that is being delivered to the board and management, but rather who wins and who loses. Proxy contests are one example. In those cases, it is critical to both sides that the votes of investors who are supporting them make their way through the system and are given their full weight at the meeting.

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[20] U.S. hedge funds own an average of 7.21% of the S&P Index. Over 75 U.S. hedge funds are dedicated to an event-driven, activist style of investing, managing more than $50 billion in assets in the United States alone. See Damien Park, "The year of the activist hedge fund", *FINalternatives* (11 March 2008), online: <http://www.finalternatives.com/node/3811>. One U.S. study found that the number of funds and events increased from 39 (97) funds (events) in 2001 to 126 (252) funds (events) in 2006. See Alon Brav *et al.*, "Hedge Fund Activism, Corporate Governance, and Firm Performance" (2008) 63 J. Fin. 1729 [Brav]. According to Bloomberg data, hedge funds own an average of 4.55% of the common equity of TSX/S&P Index.

1.3.1 Director Elections

The right to elect directors is fundamental to the relationship between investors and issuers. The results of a shareholder vote obviously matter in the event of a contested director election (a proxy contest). However, where an issuer has adopted majority voting, the level of support that accrues to (or is withheld from) individual directors is also closely watched. In the absence of majority voting, shareholders withhold from the entire slate of directors put forward. Each of these issues is discussed below.

1.3.1.1 Proxy Contest

While shareholders elect directors, the board of directors of the issuer recommends individuals to be elected to each of the available positions. These are the "management nominees" or the "management slate". Anyone else who puts a nominee forward is typically referred to as a "dissident", and that person's nominees are the "dissident nominees" or the "dissident slate".[21] In some cases, the dissident may nominate individuals for each of the available positions, and in others the dissident may put forward only a few nominees to replace certain management nominees (a "short slate").

The voting results alone are not enough to understand the outcome of a proxy contest (or many other shareholder votes). The history of the relationship between the dissident and the issuer is very often relevant, as is the composition of the investor base. Hedge funds, for example, sometimes use proxy contests as a means of moving their vision for the issuer forward. For example, in 2009, two Crescendo Partners funds filed a dissident circular in connection with the 2009 annual meeting of The Forzani Group Ltd. The funds were concerned that the independent members of Forzani's board did not have enough share ownership, that the incumbent board failed to take advantage of opportunities to crystallize shareholder value and that Forzani's capital allocation and revenue growth did not generate significant shareholder value. The Crescendo funds sought to have two of its own nominees elected so as to "rejuvenate" the board, according to its dissident circular. At the annual meeting, shareholders rejected Crescendo's nominees and elected all eight of Forzani's nominees.

Moreover, the fact that no proxy contest occurred is often a story in itself, reflecting an agreement between the dissident and the issuer (and likely what each party believes the results of a proxy vote might be). For example, in 2009, after a lengthy dispute concerning the process and terms of the failed acquisition of Lundin Mining Corporation by HudBay Minerals Inc., SRM Global Master Fund LP filed a dissident circular in connection with the 2009 special meeting of HudBay, seeking the approval of a resolution to remove the incumbent directors in favour of its own slate. The HudBay board resigned shortly before the meeting in light of preliminary proxy vote counts and the SRM nominees were elected. Also in 2009, after more than a year of discussions with the board of Canadian Superior Energy Inc., Palo Alto Investors, LLC ("PAI") launched a proxy battle, seeking shareholder support in the election of a new "more experienced, qualified and independent Board of Directors focused on maximizing shareholder value," according to the letter accompanying the proxy. PAI was largely successful at the shareholders

[21] There is some resistance to the term "dissident" because of its pejorative tone (which is not intended here), but it remains the commonly used term in this context.

meeting, as Canadian Superior Energy recommended a new board of directors largely hand-picked by the hedge fund. PAI had nominated four of Canadian Superior's proposed slate of directors and approved the other two nominees, all of whom were elected.

1.3.1.2 Majority Voting

The most significant development in director elections in Canada in recent years[22] has been the move towards majority voting. Majority voting has been adopted by approximately 50 percent of all members of the S&P/TSX Composite Index.[23]

Investors advocate majority voting because it allows them to use their votes to express their views on each individual director and to increase the likelihood that directors who do not enjoy the confidence of the investors will not remain on the board. Under most corporate statutes, votes cannot be cast against a director nominee – a vote can either be cast for the nominee or it can be withheld. Since the nominee only needs a majority of votes *cast* in order to be elected, all the nominee really needs is for one vote cast (which can only be cast in favour) in order to be elected. While this seems inconsistent with principles of shareholder democracy, it is consistent with other provisions of the corporate statutes which operate to prevent a situation in which a corporation could be left without a board.[24] It does, however, render the vote in uncontested director elections almost meaningless. Majority voting gives the views of investors' teeth.

In order for majority voting to be effective, three elements must be present. First, investors must be able to cast their votes in respect of each nominee individually, rather than voting for a slate. Slate voting has been almost universally used until recently, but it is not a legal requirement. It is merely a convention adopted by most issuers (whether for efficiency at the meeting or in order to protect individual directors from embarrassment). Second, if more than a specified percentage of votes are withheld from a director, there must be some repercussion. Often, for example, if a majority of votes is withheld, the issuer's policy may require that the director offer his or her resignation. Finally, the percentage of votes withheld must be disclosed. This may or may not be required, depending on whether the vote was conducted by show of hands or by ballot. Without the prospect of disclosure (and the resulting embarrassment), the concern is that issuers and directors will take the issue less seriously.

Investors withhold votes for a variety of reasons. In some cases, investors object to the individual, either because they do not consider the person to be independent or because they feel the person is on too many boards, for example. In other cases, they withhold votes in connection with board performance. They withhold from the chair of the audit committee (or the entire audit committee) if there has been a financial statement restatement, for example, or from the chair of the compensation committee (or the entire compensation committee) if they object to the issuer's compensation philosophy. Recent voting results demonstrate that shareholders are using their withhold option to express their views. In 2010, of the 142 issuers who reported their voting

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22 In the United States, the recent elimination of the broker vote with respect to director elections has also been a significant change. In Canada, brokers (and other intermediaries) may not vote without instructions from the client.

23 Canadian Coalition for Good Governance.

24 This would be possible if no nominee put forward received the support of a majority of votes cast.

results for director elections, the average percentage of votes withheld was 8.9 percent of votes cast. Fifteen issuers had at least one director that received 20 percent or more votes withheld with respect to his or her nomination. Seven issuers had at least one director that received 25 percent or more votes withheld with respect to his or her nomination.[25]

The importance of accurate voting results in connection with the election of individual directors cannot be overemphasized. Directors focus closely on these results, in particular where majority voting is in place. Most directors are able to recall their individual withhold votes to the second decimal place. In this paper, we raise for consideration, the possibility that the results may not be accurate, certainly not to the level of the second decimal place. One of the most prominent examples of a tabulation mistake in connection with director elections came in the United States at the 2008 Yahoo! annual meeting, when voting results announced after the meeting proved to be incorrect. Rather than a withhold vote of 14.6 percent for Yahoo! CEO Jerry Yang as originally reported, a review demanded by an investor resulted in a revised withhold vote of 33.7 percent. The details of this tabulation mistake are discussed in Section 30.3.1.

1.3.1.3 Withholding from the Slate

Where majority voting is not in place, investors may use their withhold vote against entire slates of directors. For example, in 2009, 32.3 percent of shareholders withheld their votes on the slate of directors put forward by IAMGOLD Corporation.[26] In 2010, 53.64 percent of the votes cast at the Linamar annual meeting were withheld from management's proposed slate of directors. This number is even more significant in view of the fact that founder Frank Hasenfratz controls 23.56 percent of the shares.[27]

1.3.2 Shareholder Proposals

We have discussed the importance of the shareholder proposal as a tool for shareholders expressing their views through their votes (see Section 1.2.2). In the 2010 proxy season, a total of 48 proposals were put before Canadian investors.[28]

1.3.3 Shareholder Approval Required by the TSX

The TSX and TSX Venture require shareholder approval for certain matters, including shareholder rights plans and for equity compensation plans. Equity compensation plans in particular can attract significant dissent from shareholders. In 2010, Canadian Natural Resources Limited attracted only 57.5 percent support for the amendments to its stock option plan. At the TransAlta Corporation meeting, only 52.32 percent of votes were cast in favour of the

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25 Statistics provided by the Canadian Coalition for Good Governance.

26 IAMGOLD Corporation, Report of voting results (NI 51-102 s. 11.3) (22 May 2009), online: <http://www.sedar.com>. The board of IAMGOLD made no public comment about these results. This report is filed on SEDAR under "Management Proxy Materials: Report of Voting Results".

27 Linamar Corporation, Report of voting results (NI 51-102 s. 11.3) (25 May 2010), online: <http://www.sedar.com>. At the meeting, 75.98% of the votes outstanding were cast. This report is filed on SEDAR under "Management Proxy Materials: Report of Voting Results".

28 Shareholder Proposal Database, online: SHARE <http://www.share.ca/shareholderdb/>.

amendments to the share option plan and 54.05 percent were cast in favour of the amendment to the performance share ownership plan. In 2009, the amendments to the stock option plan for Neo Material Technologies Inc. passed with only 50.7 percent of the votes cast.

Shareholder rights plans can also be controversial. As is the case with many shareholder votes, interpreting the results of votes relating to rights plans requires an understanding of the context in which the plan was put to shareholders and the composition of the issuer's investor base. The voting results for rights plans considered by shareholders in 2010 do, however, illustrate that the accuracy of the vote count has the potential to impact the result. For example, two plans were approved by a narrow margin (Allied Properties Real Estate passed with a vote of 58.95 percent and Neptune Technologies & Bioressources Inc. passed on a vote of 50.70 percent in favour). Others were also defeated by a similar narrow margin (in Hardwoods Distribution Income Fund the vote was 53.52 percent and in WGI Heavy Minerals, Incorporated the vote was 53.41 percent against the plans).

1.3.4 Votes to Approve Major Transactions

Shareholder approval is also required to approve certain types of transactions. There are many examples of transactions that have received overwhelming shareholder approval. In 2010, 98.07 percent of votes cast at the Suncor meeting approved the transaction with Petro-Canada and 99.53 percent of the votes cast at the Encana meeting supported the Cenovus transaction. In other cases, the vote is much closer, making the quality of the vote a much more important issue. In 2009, the unitholders of the Citadel Group of Funds were asked to vote on what was essentially a battle for control over that entity. At the first special meeting, a majority of each of the funds voted in favour of the proposal before them (votes in favour ranged from 58 to 74 percent), but failed to reach the 75 percent threshold required. At the second meeting, the reorganization and merger of Citadel and Brompton passed with 94 to 98 percent approval of each of the funds.

1.4 Disclosure of Voting Results

As noted in the discussion of majority voting (Section 1.3.1.2), disclosure of the voting results has become an important feature of shareholder voting. Canadian securities law requires that an issuer file a report promptly following a meeting of securityholders. That report must disclose a brief description of the matter voted upon and the outcome of the vote. If the vote was conducted by ballot, the report must include the percentage number of votes cast for, against or withheld from the vote.

Under Canadian law, a shareholder vote can be conducted by ballot or by show of hands. Statutes vary, but the CBCA provides, for example, that (unless the by-laws otherwise provide), voting at a meeting of shareholders must be by show of hands, unless a ballot is demanded by a shareholder or proxyholder entitled to vote.

From a practical perspective, if voting is done by show of hands, it may not be possible to say precisely how many votes for and against were cast or how many votes were withheld. Moreover, it is not necessary, since a vote passes once a certain threshold is passed (a majority of votes cast in the case of an ordinary vote or two-thirds of votes cast in the case of a special resolution). Where voting is by ballot, there is a written record that can be reviewed and proofed.

At many shareholder meetings of public meetings, the formal voting is done by show of hands, but the results of the vote are already known because proxies must be deposited prior to the proxy cut-off time. Moreover, in many cases, when the meeting chair calls for a show of hands, many people in the room raise their hands, whether or not they are entitled to vote at that point or at all (in some cases, they are investors who have provided voting instructions to their intermediaries). In other words, the show of hands can be somewhat ceremonial. However, if that is the way in which the vote is conducted, it is open to the issuer not to disclose the results of the vote (since the requirement applies only to votes conducted by ballot). Nevertheless, many such issuers disclose the results of the vote as set out in the proxies.

The CCGG maintains statistics of the voting results disclosed for the S&P/TSX Composite Index in 2010; only 142 issuers (62.56 percent) disclosed detailed voting results of their director elections.

1.5 Costs of a System That is Not Working Effectively

If the proxy voting system is not working effectively (if the quality of the vote is in question), there are costs to both investors and issuers.

Investors may be deprived of an important right for which they have paid. They will also have wasted the resources they have devoted to ensuring that their views are known to the issuers in which they invest. Finally, the matters put to a shareholder vote may not be decided on an appropriate basis.

Issuers too will have wasted at least some resources applied to creating and delivering proxy materials. They will not have a clear understanding of the views of their investors and therefore of formulating recommendations that will have the support of their investors.

Finally from the perspective of both issuer and investor, if investors cannot communicate effectively with issuers and their boards through the proxy voting process, attempts at shareholder engagement (which have tensions on both sides) may not be meaningful.

2 Where the System Fails

Most investors, and many issuers, assume that the proxy voting system is reliable. There are a number of reasons to suspect that it may not be.

2.1 Criteria for an Effective System

In order to determine whether the proxy voting system is effective, we have developed criteria against which to assess its effectiveness. In our view, an effective proxy voting system must satisfy at least the following five criteria:

- investors must be in a position to make an informed decision about how to vote or how to direct that their votes be exercised and must therefore have adequate time to review the proxy materials;

- investors must be able to cast their votes or provide voting instructions in accordance with rules that are clearly explained, impartially applied and practical for investors to follow;

- if an investor casts a vote or provides voting instructions in accordance with the established rules, that vote must be given its full weight at the shareholder meeting in question;

- votes attached to the securities of an issuer should be cast by those investors who hold the economic interest associated with those securities; and

- there must be sufficient transparency in the voting system so that both issuers and investors are confident that the system works.

2.2 Why We Say That the Criteria for an Effective System Are Not Satisfied

Our research has led us to conclude that it is reasonable to question whether the five criteria proposed as the standard for an effective proxy voting system are satisfied on a consistent and reliable basis. The machinery of the proxy voting system is highly complex and lends itself to a variety of administrative weaknesses and errors. The large number of votes processed by the system may render these weaknesses and errors immaterial in the aggregate, but differences between the result of the votes cast and those counted can be important – even material – in the context of a specific vote. The system is largely operated by a variety of third-party service providers who do not collectively provide an end-to-end audit trail or a confirmation that votes cast have been counted. In respect of any particular vote, no one may be aware of errors that have occurred. When errors are discovered, it may not be possible to correct them in a timely manner.

This paper explains the reasons for our concern in greater detail, but the following provides a summary.

2.2.1 Delivery of Materials

Proxy materials do not always reach the investors in time for them to provide their voting instructions. Securities regulations set out certain steps that the participants in the proxy system must take in order to ensure timely delivery of materials and the participants in the system themselves have taken a number of steps to streamline this system. However, administrative or processing errors at various points in the system can interfere with the flow of materials down this chain.[29] In one recent situation, a senior executive of an issuer reports that the materials for

[29] A British study from 2004, sponsored by the Depository Trust & Clearing Corporation [DTCC], estimated that failures in processing communications between issuers and investors could cost the European asset management industry between €90 million and €143 million per year. The study also reported that intermediaries employ up to 40 persons for the sole purpose of "scrubbing" information to reduce errors

her company's annual meeting were delivered to her home (in her capacity as an investor) several days after the meeting had been held, even though her company had met its mailing deadlines.

In addition, the system has cut certain investors adrift. Issuers are not required to pay for the materials to be sent to some investors who have opted to maintain their anonymity.[30] If the broker or other intermediary is not willing to absorb the cost or able to pass the costs on to the investor, the materials will simply not be sent to that investor.

2.2.2 Absence of Clear, Practical Rules That Are Consistently and Impartially Applied

The process and rules in place which allow investors to direct how votes are cast are complicated. Investors do not always understand the rules and, as a result, do not always comply with the voting requirements. Experience shows that voting instruction forms (the documents used by beneficial holders to vote their shares) are far from intuitive. Moreover, disclosure in proxy materials explaining how investors exercise their right to direct how votes associated with their investment are cast is often inadequate, incorrect or misleading.

Additional concerns arise because there are no legal or regulatory standards that govern how votes (or voting instructions) are to be handled, other than fundamental common law principles of procedural fairness. Accordingly, these matters may be handled differently from meeting to meeting. Issuers can set their own deadlines for the receipt of proxies – and can waive those deadlines if they so choose. Intermediaries make certain decisions about which voting instructions to count when they (or their agent) are tabulating the voting instructions received from their client. Transfer agents have established a protocol for determining how they will deal with a variety of issues presented by the way in which proxies and voting instructions are delivered, but at the end of the day, the final decision rests with the issuer.

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and increase accuracy. See Oxera, "Corporate action processing: what are the risks?" (May 2004), online: The Depository Trust & Clearing Corporation <http://www.dtcc.com/downloads/leadership/whitepapers/2004_oxera.pdf>.

[30] Referred to as objecting beneficial owners [OBOs] and discussed throughout this paper.

2.2.3 Votes Properly Cast Are Not Always Given Their Full Weight

Once an investor has provided voting instructions, a number of things can happen to prevent the vote from being counted or given its full weight. Voting instructions can be disregarded through error, either on the part of the investor or on the part of the tabulator. Over-voting can result in validly cast votes being diluted. When a vote is cast more than once, the solution often involves pro-rating some or all of the votes, or counting some and not others. Thus, an investor could have its vote diluted, pro-rated or disallowed, without ever knowing this has happened.

2.2.4 Little Transparency or Accountability in the System

There are a number of parties involved in the proxy voting system. Issuers, intermediaries and investors have all outsourced significant aspects of their responsibilities to third-party service providers. The third-party support structure has vastly improved the clearance and settlement of securities transactions and has also improved the efficiency of proxy materials distribution. Yet it has also made the proxy voting system more complex and less transparent. There are no end-to-end audits of the system to determine whether it is operating effectively as a whole and such audits may not even be feasible at this point. Nor is there any method being used in Canada to confirm that a voting instruction has resulted in a vote being cast at the meeting.[31]

Every provider has its own systems and ways of bridging communication between issuer and investor. The approach and timing will depend partly on which transfer agent is involved and how communication responsibilities are divided between the transfer agent and Broadridge.[32]

2.2.5 Who Votes the Shares

Votes are often cast by persons who no longer have – or never had – an economic interest in the issuer.

Investors whose names appear on the mailing list (and who will therefore receive proxy and voting materials) may, as a result of subsequent trading activity, no longer hold any interest in the issuer by the time voting instructions are solicited or the meeting is held. In addition, as a result of certain types of securities lending, the person who is entitled to vote a share will only have a temporary economic interest in the issuer. Certain financial instruments also allow

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[31] U.S. Securities and Exchange Commission, Release No. 34-62495, "Concept Release on the U.S. Proxy System" (14 July 2010), online: <http://www.sec.gov/rules/concept/2010/34-62495.pdf> at 39 [SEC Concept Release]. The SEC Concept Release notes the following:

> The inability to confirm voting information is caused in part because no one individual participant in the voting process – neither issuers, transfer agents, vote tabulators, securities intermediaries, nor third-party proxy service providers – possesses all of the information necessary to confirm whether a particular beneficial owner's vote has been timely received and accurately recorded. A number of market participants contend that some proxy service providers, transfer agents, or vote tabulators are unwilling or unable to share voting information with each other or with investors and securities intermediaries. There are currently no legal or regulatory requirements that compel these entities to share information with each other in order to allow for vote confirmations.

[32] Broadridge Financial Systems, Inc., discussed in greater detail in Section 16.

persons to acquire the right to vote a security without having any economic exposure to the issuer.

2.3 Practical Examples of Problems with the System.

There are many examples of issues that have occurred in the Canadian marketplace. In the course of our own practice, as well as our research and discussions with system participants in connection with this paper, we have learned of a number of situations in which problems have occurred. Some of these examples affected the outcome of the meeting. We are not at liberty to disclose or discuss many of these situations, but they have convinced us that there are serious flaws in the system that must be addressed. Many others who are well acquainted with the operation of the system agree.

A number of very public examples of problems created by various parts of the voting system are discussed throughout this paper, including:

- tabulation errors at the 2006 meeting of unitholders of Gateway Casinos Income Fund to approve a related party transaction (see Section 30.3.2);
- the over-vote of 6.3 million shares during the 2008 proxy contest at Biovail Corporation (see Section 31.1);
- the over-vote of 26 million shares at the 2004 IAMGOLD shareholder meeting to approve the proposed merger with Wheaton (see Section31.1);
- failure to capture all of the votes at the EMS annual meeting in 2005 as a result of computer problems at the proxy agent (see Section 30.3.3); and
- disqualification of votes cast by 1.2 million (6 percent) of the Class B stock against the Molson Coors merger in 2005 (see Section 30.2).

Similar issues arise in the United States, prompting Gil Sparks, a prominent corporate litigation lawyer to remark that in a contest that is closer than 55 to 45 percent, there is no verifiable answer to the question, "Who won?"[33]

3 U.S. Developments

3.1 Why U.S. Developments Are Relevant to This Discussion.

The U.S. marketplace is an important point of comparison for the Canadian proxy voting system for several reasons. The U.S. and Canadian legal and regulatory systems relevant to proxy voting are very similar. They are not, however, identical and so there is a great deal that each jurisdiction can learn from the other about changes and improvements to its own system.

[33] A. Gilchrist Sparks III, Counsel, Morris, Nichols, Arsht & Tunnell LLP, Wilmington, Delaware, personal oral communication to author in Kahan & Rock, *infra* note 269 at 1279.

There are three recent developments in the United States that are particularly relevant to the issues discussed in this paper: the SEC Concept Release, the *Dodd-Frank Act* and the NYSE Report on Corporate Governance.[34]

3.2 SEC Concept Release

In July 2010, the SEC released a concept paper, soliciting comment on various aspects of the U.S. proxy system. It outlines some of the concerns that have been raised regarding the reliability, transparency, accountability, and integrity of the proxy system as well as some possible regulatory responses. The concerns raised generally relate to three principal questions:[35]

- whether the SEC should take steps to enhance the accuracy, transparency, and efficiency of the voting process;
- whether the SEC's rules should be revised to improve shareholder communications and encourage greater shareholder participation; and
- whether voting power is aligned with economic interest and whether the SEC's disclosure requirements provide investors with sufficient information about this issue.

Perhaps most importantly, the SEC Concept Release stresses the importance that the proxy voting system is seen to be fair: "Because even the perception of such defects can lead to lack of confidence in the proxy process, we seek to explore concerns that have been expressed about the accuracy, transparency, and efficiency of that process and ways in which those concerns might be addressed."[36]

3.3 The *Dodd-Frank Act*

The *Dodd-Frank Act* came into force in 2010. This legislation brought proxy access one step closer for U.S. shareholders.[37] The specifics of the changes that it will bring to U.S. corporate governance will be subject to SEC rules, but they include greater shareholder input on executive compensation, both through say on pay and through enhanced disclosure about executive compensation.

Prior to the passage of the *Dodd-Frank Act*, increased engagement by shareholders of U.S. public companies had already become apparent. Nevertheless, as noted in a 2009 U.S. report, "[w]hile tensions between the roles and, in particular, the decision rights of shareholders and

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34 NYSE, "Report of the New York Stock Exchange Commission on Corporate Governance" (23 September 2010) [NYSE Corporate Governance Report].

35 SEC Concept Release, *supra* note 31 at 9.

36 SEC Concept Release, *supra* note 31 at 25.

37 See Carol Hansell & Ted Dove, "Flash: SEC Adopts Final Rules for Shareholder Proxy Access" (27 August 2010), online: Davies Ward Phillips & Vineberg <http://www.dwpv.com/en/17620_25279.aspx>. The SEC has stayed the effectiveness of its recently announced proxy access rules as a result of a legal challenge made by two leading business organizations. It is unlikely that this challenge will be resolved in time for the 2010 proxy season. The rules would otherwise have taken effect on November 15, 2010 Daniela Liscio, "Flash: SEC Stays Effectiveness of Proxy Access Rules" (6 October 2010), online: Davies Ward Phillips & Vineberg <http://www.dwpv.com/en/17620_25407.aspx>.

boards are apparent, to date the roles and responsibilities have not shifted to any significant degree."[38] A year later, Holly Gregory, the chair of the task force that produced that report, writes: "Taken together, the corporate governance provisions of the *Dodd-Frank Act* will give shareholders of U.S. public-traded companies a significantly greater voice in corporate affairs."

This paper incorporates references to certain aspects of the *Dodd-Frank Act* that are relevant to this discussion.

3.4 NYSE Corporate Governance Report[39]

In September 2010, the New York Stock Exchange Commission on Corporate Governance released its report. In response to the financial crisis of 2008 and 2009, the Commission was charged with conducting a comprehensive review of corporate governance principles and developing a set of core governance principles which could be widely accepted and supported by issuers, investors, directors and other market participants. The Commission was able to reach consensus on 10 core principles. At least three of these core principles are directly relevant to this paper. One relates to the importance of the shareholder vote, which we address in Sections 1 and 45 of this paper.[40] Another relates to the accountability of proxy advisory firms, an issue that is addressed in Sections 20 and 44.[41] The third encourages the SEC to work with the NYSE and other exchanges to ease the burden of proxy voting and communication.[42] This issue was the impetus for the research and writing of this paper.

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38 See ABA, "Final Report of the Task Force of the ABA Section of Business Law Corporate Governance Committee on Delineation of Governance Roles & Responsibilities" (1 August 2009), online: <http://www.abanet.org/buslaw/committees/CL260000pub/materials/20090801/delineation-final.pdf>. The Task Force was chaired by Holly Gregory of Weil, Gotshal & Manges LLP. Carol Hansell (one of the authors of this paper) was a member of that Task Force and is the Chair of the Corporate Governance Committee of the American Bar Association (Business Law Section).

39 NYSE Corporate Governance Report, *supra,* note 34.

40 *Ibid*. Principle 3 - Shareholders have the right, a responsibility and a long-term economic interest to vote their shares in a thoughtful manner, in recognition of the fact that voting decisions influence director behavior, corporate governance and conduct, and that voting decisions are one of the primary means of communicating with companies on issues of concern.

41 *Ibid.* Principle 8 - The Commission recognizes the influence that proxy advisory firms have on the market, and believes that such firms should be held to appropriate standards of transparency and accountability. The Commission commends the SEC for its issuance of the Concept Release on the U.S. Proxy System, which includes inviting comments on how such firms should be regulated.

42 *Ibid.* Principle 9 - The SEC should work with the NYSE and other exchanges to ease the burden of proxy voting and communication while encouraging greater participation by individual investors in the proxy voting process.

PART II – EVOLUTION OF THE SYSTEM

One of the most important features of a vibrant capital market is the ability to initiate, execute and settle trades quickly. Investor demands have forced the capital markets to abandon paper-based trading systems in which investors take physical ownership of shares, evidenced by a share certificate in their name. Capital markets now operate on the basis of indirect ownership – where investors do not take legal ownership of the shares in which they invest but instead acquire an entitlement to the benefits associated with those shares, including the right to vote and the right to receive dividends. Those benefits flow to investors from the legal owner of the shares through a waterfall of intermediaries in what is often referred to as the "book-based system".

4 Move to a Centralized Clearing System

4.1 The Paperwork Crisis: Impetus to Change in the United States

The growth in capital markets activity in the United States in the 1960s was enormous. Three million shares traded per day on the New York Stock Exchange ("NYSE") became 13 million shares per day 10 years later, an increase of over 400 percent. This increase in volume strained the ability of the marketplace to execute and settle claims efficiently.

One of the main sources of this strain was the fact that investors held their shares through the "direct holding system". They took physical delivery of their share certificates and were shown on the issuer's books as the registered shareholders. Another was the fact that the system was almost entirely paper-based. Securities trades were settled by delivery of share certificates in return for payment, usually by cheque (known as delivery against payment, or delivery versus payment). By the time the "paperwork crisis" of the late 1960s and early 1970s occurred, a brokerage firm in the United States needed 33 different documents to execute and record a single securities transaction.[43]

Another source of strain was the fact that the clearing and settlement process was labour intensive, expensive and prone to errors in handling and recording transactions. These and other drawbacks (paper certificates could be lost, stolen or counterfeited) caused trade settlement fail rates to soar. The process was also time consuming and the time lag between trade and settlement exposed a trade party to the risk that its counterparty could fail before the trade settled. Even if the trade did settle, the proceeds were not available for investment until settlement had occurred. Processing trading paperwork became such a burden that the exchanges and the National Association of Securities Dealers ("NASD") were forced to shorten the trading day to alleviate back-office backlog and exchanges closed every Wednesday and

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[43] Larry E. Bergmann, "The U.S. View of the Role of Regulation in Market Efficiency" (Speech delivered at International Securities Settlement Conference, 10 February 2004), online: <http://www.sec.gov/news/speech/spch021004leb.htm>. See also Alberta Law Reform Institute, *Transfers of Investment Securities*, Report No. 67 (Edmonton: Alberta Law Reform Institute, 1993), wherein *Study of the Securities Industry*, Hearings Before the Subcomm. on Commerce & Finance of the House Comm. on Interstate & Foreign Commerce, 92d Cong., 1st Sess. (1972) at 1597 is cited as noting that 210 different documents were prepared by one particular brokerage firm to consummate a single transaction.

extended settlement to five days after the trade date (T+5) from four days after the trade date (T+4).

The fact that the clearing and settlement was operated by subsidiaries of the NYSE, American Stock Exchange ("AMEX") and over-the-counter ("OTC") exchanges, as opposed to being centralized, caused a further strain on the system.

4.2 Solutions to the Paperwork Crisis

4.2.1 National Clearing and Settlement Systems

In response to the problems that led to the paperwork crisis, Congress mandated three important changes in the way in which the capital markets operated. The first was the establishment of a national clearing and settlement system, under the oversight of the SEC. As a result, the NYSE, AMEX and OTC exchanges merged their respective subsidiary clearing corporations to form the National Securities Clearing Corporation ("NSCC")[44] to allow participants to settle trades on any of those exchanges through NSCC, which obtained SEC registration as a recognized clearing agency and today that registration is recognized as a cornerstone in the United States establishment of a national clearing and settlement system.

4.2.2 Immobilization or Dematerialization

The second important change mandated by Congress was the "immobilization" of share certificates by maintaining them in a central location or depository and recording changes of ownership using "book-entry" accounting methods. With this change, the direct holding system was replaced by the indirect holding system, in which most investors hold their interest in the securities in which they invest through intermediaries.

4.2.3 Netting

The third important change implemented following the paperwork crisis was the netting of trades, rather than settling on a trade-for-trade basis.

Trade-for-trade settlement requires the participant to settle its obligations with a counterparty each time the participant's orders are matched to the corresponding buy or sell order with the counterparty. Net settlement reduces the number of transfers to be made and therefore reduces processing time. Under the batch net settlement option, all buy and sell orders of each participant are aggregated on a daily basis to calculate the net position changes for each security; settlement with other participants is determined on this net basis. Under the continuous net settlement option, a depository is set up as the counterparty to each transaction. In this way, the participant's orders are continuously netted against its position with the depository.

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[44] The Depository Trust & Clearing Corporation [DTCC] was created in 1999 as a holding company for NSCC and The Depository Trust Company [DTC].

4.3 Canadian Experience

The Canadian capital markets also grew in the 1960s, although not at the spectacular rates experienced in the United States. In the period from 1962 to 1967, trading on all of the U.S. exchanges increased by 171 percent in volume (194 percent in value). In the same period, trading in Canada increased by 38 percent in volume (73 percent in value). In 1989, the Toronto Stock Exchange added a (then) record 86 companies to its listed issuers.[45]

The Canadian marketplace did not experience the paperwork crisis that had crippled the U.S. financial markets, at least not to the same degree.[46] This was due in part to the smaller size and volume of activity in Canada relative to the United States and the slower growth in volume of trading and certain settlement process differences which reduced both the amount of paper and errors involved in processing trade settlements. Unlike the rapid pace of broker-dealer firm failures in the United States, no Canadian firms failed through loss of control of their operations.[47]

However, Canadian authorities also recognized the need to reconsider existing settlement practices and that a central clearing agency could improve the clearing and settlement systems by immobilizing share certificates. In 1965, Ontario appointed the Select Committee on Company Law to initiate reforms to the corporate statute of Ontario. The report of the Select Committee in 1967 found, among other things, that the "share transfer system contemplated by the Act, is, plainly, an old fashioned 'book stock' or registration of title concept, which seems to have evolved in the 19th century as a result of the refusal of law to recognize a company share as a chose in action and a share certificate as a negotiable instrument." Further, the Select Committee recommended "necessary legislative changes to permit the establishment of a central depository system and Stock Clearing Corporation."[48]

4.4 Clearing System in Canada

4.4.1 Establishment of CDS

The Canadian Depository for Securities or "CDS" was incorporated in 1970 as a national central securities repository and clearing and settlement system. Its stated purpose was to "facilitate the transfer of shares across Canada by computerized bookkeeping entries, thereby reducing the need for physical transfer of share certificates and the attendant administrative problems and

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45 (1970) Annual Review, Toronto Stock Exchange at 26-27; see also Ian F.G. Baxter and David L. Johnston, "New Mechanics for Securities Transactions" (1971), 21 U.T.L.J. 339.

46 J. Honsberger, "Failures of Securities Dealers and Protective Devices" in P. Anisman *et al.*, *Proposals for a Securities Market Law for Canada* (Ottawa: Minister of Supply and Services, 1979).

47 *Ibid*.

48 Ontario, Legislative Assembly, "Interim Report of the Select Committee on Company Law", A.F. Lawrence, Chairman, (1967) at 40-45.

costs."[49] By the end of 1977, CDS was responsible for clearing all security trades executed on the Toronto and Montreal stock exchanges.[50]

In the years between, there had been a number of false starts, a lack of consensus about how a central depository system in Canada would work and ultimately a threat that the project would fail for lack of funding.[51] The crisis was ultimately resolved by a review committee consisting of the executive director of the Canadian Bankers' Association, the presidents of the Investment Dealers Association and the Toronto Stock Exchange, and the president of National Trust (on behalf of a group of trust companies). As a result, a group of trust companies ultimately provided 20 percent of the funding with the rest split between the dealer community (represented by the Montreal Stock Exchange, Toronto Stock Exchange and the Investment Dealers Association) and by the banking community.[52]

4.4.2 Role of CDS

Once CDS was established, it was able to leverage new technologies and automation to create a centralized depository service and an electronic clearing and settlement system that could handle higher volumes and respond to the evolving needs of the market.[53] Initially, CDS provided the securities settlement service ("SSS") in respect of only a handful of equities, each individually authorized by the Ontario Securities Commission ("OSC") to be cleared through SSS. This was followed by the book-based system (BBS), which allowed for settlement based on individual trades or on a net basis at the end of each trading day on a broader range of securities. A debt clearing service ("DCS") was introduced in 1994 to process trades of government bonds and treasury bills and was expanded in 1998 to include other money market instruments. The current CDS technology platform, CDSX, was launched in 2003, supplanting the prior SSS, BBS and DCS systems and providing the Canadian markets with a comprehensive electronic debt and equity securities clearing and settlement management system. Settlement can be effected, at the option of the participant, on the basis of continuous net settlement, batch net settlement or trade-for-trade settlement. To support operations, CDS has a full back-up data centre which replicates its production data centre for technology resiliency. CDS's critical business operations are split between its regional offices to provide redundancy if one of the sites cannot continue to operate.

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49 *House of Commons Debates*, (2nd Session - 28th Parliament, 19 Elizabeth II, Volume VIII, 1970) at 8486; see also, H.J. Cleland, "Applications of Automation in the Canadian Securities Industry: Present and Projected" in *Proposals for A Securities Market Law* (Ottawa: Minister of Supply and Services, 1979).

50 *Ibid*. at 1003 to 1010.

51 *Ibid*.

52 *Ibid*.

53 See CDS, "History and milestones", online: <http://www.cds.ca/cdsclearinghome.nsf/Pages/-EN-HistoryandMilestones?Open>.

4.4.3 Cross-Border Aspects of CDS's Responsibilities

CDS coordinates with its U.S. counterpart, DTC, to effect cross-border settlements. DTC is linked electronically with CDS, allowing for the processing and settlement of Canadian dollar securities transactions at DTC. The link with CDS was the first DTC link to support settlement at DTC in a foreign currency, and provides DTC participants with a single depository interface for U.S. and Canadian dollar transactions. For DTC participants, this eliminates problems associated with maintaining split inventories in Canadian and U.S. issues, including high cross-border processing costs and time inefficiencies. Prior to implementation of the link, participants maintained split inventories, with some portion of a position in a dually listed issuer maintained with CDS for Canadian dollar settlement, and the remainder with DTC for U.S. dollar settlement. The link permits DTC customers to concentrate all U.S. and Canadian security positions in their DTC accounts (and vice versa for CDS participants).[54] However, there is no electronic link between CDS and DTC for the transmission of votes on shares held in CDS in the name of DTC. As a result, DTC must report those votes to the tabulator.

5 The Effect of the Indirect Holding System on Communications Between Issuers and Their Investors

5.1 The Broken Communications Link Between Issuers and Their Non-Registered Investors

The indirect holding system eliminated the direct relationship between the issuer and all of its investors other than its registered shareholders. Non-registered investors now have a relationship with their intermediary, but none with the issuer itself. This has created a barrier between issuers and investors that makes it very difficult for them to communicate with one another. The issuer has no way of knowing who its non-registered investors are and there are no established mechanics for non-registered investors to communicate their voting instructions.

5.2 Regulators Step In to Realign Communications

Canadian securities regulators recognized that the communications barrier between issuers and non-registered investors had the potential to disenfranchise the non-registered investors because the issuer could not deliver proxy materials to those investors and the non-registered investors had no reliable way to deliver voting instructions through the various layers of intermediaries so that those instructions would be reflected at the shareholder meeting. In response, the Canadian Securities Administrators ("CSA") devised a process to allow the issuer and its non-registered investors to communicate through the walls of intermediaries and mandated that the market participants involved in the process – issuers, depositories, intermediaries, transfer agents – take certain actions to enable those effective communications. Those requirements were originally set out in National Policy 41 ("NP 41"), which came into force in 1987.[55] NP 41 was repealed in

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[54] CDS also maintains a link with CAVALI, Euroclear France, Japan Securities Depository Centre Inc. (JASDEC) and Skandinaviska Enskilda Banken AB (SEB).

[55] *Shareholder Communication*, O.S.C. NP 41, (1987) 10 O.S.C.B. 6307 (28 October 1987).

2002 in favour of National Instrument 54-101 ("NI 54-101").[56] These instruments are discussed in more detail below.

5.3 Intermediaries Outsource Their Responsibilities to Broadridge

One of the most important roles in the communications system devised by the securities regulators is played by the intermediaries, since they have all of the information about the identity and holdings of all of the issuer's non-registered investors. Under the securities regulatory regime, responsibility is imposed on the intermediaries for passing proxy materials on to their clients and then for collecting their voting instructions and giving effect to those instructions through the proxies. For the intermediaries, this is entirely a "back office" function; an administrative responsibility that does not generate income. Broadridge recognized the opportunity to service the intermediaries by performing this function for them. Today, Broadridge performs these functions for virtually all of the intermediaries in Canada and Broadridge's investment dealer clients are, by all accounts, highly satisfied with the services that Broadridge provides.[57]

6 Role of Technology

6.1 Importance of Technology

Electronic technology allows us to do much of what we now take for granted, and shareholder voting is no exception. The paper-based system of 50 years ago has all but been replaced by technology. Manual processing has given way to computer processing and communication now flows over the Internet. The vast majority of investors vote electronically and some even attend shareholder meetings over the Internet. Most recently, Canadian regulators have proposed an approach to a "notice-and-access" regime, which will begin the process of eliminating the last paper-based aspect of the shareholder voting system – the delivery of proxy materials.

Technology allows the capital markets to operate at the speed and with the efficiency investors demand. Every technological advance contributes to greater efficiencies. Technology can, of course, be flawed in some aspects of its application and does not always solve the problems to which it is applied, but continual improvements bring enormous benefits. Technology can also help its users to respond to changing regulatory requirements.

6.2 Who is Responsible for the Technology On Which the Capital Markets Depend?

There are a number of things to keep in mind when considering the technology issues associated with the matters discussed in this paper.

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[56] *Communication With Beneficial Owners of Securities of a Reporting Issuer*, O.S.C. NI 54-101 (2002) 25 O.S.C.B. 1863 introduced the terms non-objecting beneficial owners [NOBOs] and objecting beneficial owners [OBOs].

[57] As reported by their industry association, the Investment Industry Association of Canada [IIAC].

First, proprietary computer systems have been developed by a variety of participants in the securities industry to respond to regulatory requirements, drive efficiency, reduce costs and offer additional services. Connectivity and integration have been built between many of the participants, including Broadridge, CDS, DTC, brokers' back offices and transfer agents. However, there is no single comprehensive and unified platform that flows communication from the issuer through to these various intermediate hands, then to the investor and back again.

Second, developing and maintaining technology is very capital intensive. Even existing service providers will calculate when the capital investment can generate a return in the Canadian market. In proposing solutions to the problems that exist in the voting system, the inevitable question is who will bear the costs of those solutions and whether the benefits are commensurate with the costs.

Third, technology has the power to be both a market force and a game changer. As markets become more global, international service providers with world-class technology will have the ability to gain market share by leveraging economies of scale, with the result that smaller, less capitalized participants may exit the field. The power of technology as a game changer is already well-documented – one need only look at the pervasiveness of technologies like email, the Internet and texting compared to 10 years ago to realize that the one constant of technology is change. So in hypothesizing the ideal proxy voting system, the wild card is technology and how it can make the hypothesis a reality.

Ideally, there would be a single platform that all participants – issuers, CDS, intermediaries, transfer agents, NOBOs and OBOs[58] – would use to distribute proxy materials and return votes, with sufficient controls imposed to preserve anonymity where needed and permit independent audit down and up the chain of communication and voting. It is almost trite to say "we have the technology" to build such a system, at least in respect of domestic participants.[59] The real issue is, of course, who would pay for it, who would own it and who would operate it. As noted elsewhere in this paper, one of the issues with the current system is that no one participant in the process owns the problem. CDS sees itself as neutral in the process, likely because its functions are participant driven. CDS does, however, through its subsidiaries, provide other services under contract to the CSA, such as the operation of SEDAR.[60] While a number of improvements to the proxy voting process have been made without regulatory intervention—telephone voting and Internet delivery of materials are two examples—history demonstrates[61] that, in the absence of a regulatory requirement, it is unlikely that issuers or intermediaries would act in the common good to develop such a system; intermediaries in particular having already demonstrated their willingness to simply outsource their obligations to Broadridge. The most likely scenario is that regulatory requirements for accountability and auditability, and evidence that issuers and

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58 NI 54-101 introduced the terms non-objecting beneficial owners [NOBOs] and objecting beneficial owners [OBOs].

59 Where beneficial owners reside in other countries, the issue becomes more complex.

60 System for Electronic Document Analysis and Retrieval [SEDAR].

61 The Congressional studies of the U.S. paperwork crisis found that a fundamental weakness of the U.S. system was the absence of a mechanism to give direction to, and ensure co-operation and coordination among, the disparate entities involved in the clearing and settlement process.

intermediaries are correctly fulfilling their obligations, will drive free market participants to build a better voting platform. The likely candidates are Broadridge or a major transfer agent.

Finally, despite the considerable expense and effort to make technology systems robust[62], technology should not be assumed to be infallible. While human error is always a factor in any process, we were provided with anecdotal reports of occasional technology system failures. In one case, a proxy solicitor's system simply failed to communicate the votes registered in that system to Broadridge's system. In another case, a transmission error by Broadridge caused Yahoo! Inc. to initially show fewer votes withheld from board members in the results of a shareholder meeting than was actually the case. While the revised report did not change the election's outcome, it did indicate weaker support for the management slate than Yahoo! had first reported.[63]

7 Purpose and Limitations of the Securities Regulatory Requirements

7.1 Mandate of the Regulators

Ensuring that investors are able to exercise the voting rights associated with the securities in which they have invested falls clearly within the mandate of the securities regulators. The CSA addresses this mandate in part by setting out requirements dealing with communications between the issuer and the investor through the intermediaries,[64] supplementing the corporate law requirements. The CSA has articulated the following fundamental principles underlying its approach to regulating shareholder communications:

- all securityholders of a reporting issuer, whether registered holders or beneficial owners, should have the opportunity to be treated alike as far as is practicable;
- efficiency should be encouraged; and
- the obligations of each party in the securityholder communication process should be equitable and clearly defined.

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62 For example, Broadridge reports it has invested hundreds of millions of dollars to establish and maintain two geographically disperse data centres and network operations with Tier IV reliability, as well as to attain ISO 27001 certification for information security.

63 Crayton Harrison, "Yahoo vote misreported after Broadridge makes error" *Bloomberg* (5 August 2008), online: <http://www.bloomberg.com/apps/news?pid=20601087&sid=aHKBTuxOPjec&refer=home>.

64 NI 54-101 deals with the way in which the issuer provides proxy materials to investors and investors provide their voting instructions. NI 54-101 is the successor rule to NP 41. The CSA approved NP 41 on October 28, 1987 based upon the recommendations of the Joint Regulatory Task Force on Shareholder Communication, a task force consisting of securities regulators, corporate law administrators and representatives of stock exchanges, depositaries, transfer agents and other interested groups. The CSA were motivated in developing and approving NP 41 by the rapid growth at the time in the number of securityholders of reporting issuers who were not registered holders. The stated purpose of NP 41 was to provide a framework to ensure that materials relating to meetings of securityholders, including proxies and audited annual financial statements, were provided to such non-registered holders of securities of reporting issuers. The CSA stated in NP 41 that the goal of the Task Force and of NP 41 was to ensure that non-registered holders have the same access to corporate information and voting rights as registered holders, to ensure that the obligations of each participant in the communication chain were equitable and clearly defined, and to ensure that regulation and procedure were uniform nationwide.

The CSA's requirements with respect to an issuer's communications with beneficial owners (i.e. investors) are set out in NI 54-101,[65] which followed similar changes made to U.S. securities law several years earlier.[66]

7.2 What Securities Regulation Does Not Address

There are several things to note about securities regulation in connection with the issues addressed in this paper. First, securities regulation prescribes in great detail the steps required in order to get proxy materials to the investors. However, regulatory oversight of the voting process essentially stops after the investor has returned its voting instructions. The method and time frame for intermediaries, Broadridge, the tabulator and the meeting chair to process and count votes is not prescribed. The result is that discretion may be exercised by various participants at critical points in the process with no transparency for issuers or investors about the way in which that discretion is being exercised.

Second, some but not all of the parties who play a role in the process are regulated. Issuers, intermediaries and transfer agents are all market participants and, accordingly, securities regulators have the authority to scrutinize their activities (whether they do so or even should do so is a different issue). Broadridge, which plays an important role in the shareholder voting process, is not a market participant, although certain services it provides are regulated and it is bound by its contractual relationships with its clients to provide those services in accordance with the relevant regulations. Still, because there is no legal relationship between Broadridge and the investors or the issuer, there is no accountability between them.

Finally, securities regulators do not oversee the system as a whole, nor do they conduct compliance reviews for the parts of the system they do regulate. To the extent that securities regulators intervene, it is on an episodic and complaints-made basis.

8 CSA Involvement

Canadian securities regulators imposed detailed requirements on the steps that various parties must take in order to ensure that investors receive their proxy materials.

8.1 Reasons for Regulation

Part II of this paper describes the reasons for the capital markets moving away from the paper-intensive direct holding system to the indirect holding system made possible with the support of technology. As noted earlier, one of the results of the indirect holding system was that it interposed a number of intermediaries between the issuer and its investors. Because corporate and securities law at that time mandated only communications between the issuer and its

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[65] Canadian securities laws are a matter of provincial jurisdiction. In order for a change to be made to securities laws across the country, 13 jurisdictions (10 provinces and three territories) must agree. Such agreement is typically reflected in a "National Policy", such as NI 54-101.

[66] Council of Institutional Investors, *The OBO/NOBO Distinction in Beneficial Ownership: Implications for Shareholder Communications and Voting* (Washington: Council of Institutional Investors, 2010).

registered shareholders, a concern soon developed that communications were not reaching the non-registered investors. As a result, they were being disenfranchised.

8.2 National Policy 41 (1987-2002)

The first iteration of securities regulation of the communications between issuers and non-registered investors came in 1987 with NP 41. NP 41 created and choreographed a series of requirements for issuers, intermediaries, depositories and transfer agents designed to allow communications to flow between issuers and their non-registered investors. One of the three objectives of NP 41 was to "…ensure the non-registered holders have the same access to corporate information and voting rights as registered holders".[67]

Although NP 41 was repealed in 2002 in favour of NI 54-101, it serves as a reminder that the problems discussed in this paper have been on the capital markets radar screen for almost 25 years.

Once NP 41 was in place, the CSA formed an Industry Implementation and Monitoring Committee ("IIMC") to assess its implementation. The IIMC included representatives of different industry associations representing groups with different roles and interests in the operation of NP 41. Among the steps taken by the IIMC to assess the effectiveness of NP 41 was a 1991 survey of intermediaries and investors.

The IIMC also formed a subcommittee to investigate over-voting issues and how they might be addressed in NP 41. That subcommittee issued a report setting out its observations, conclusions and recommendations on October 5, 1995. The over-voting subcommittee recommended that NP 41 should require the reconciliation of intermediary records (see Section 36.4) and that securities lending agreements address the over-voting issue (see Section 45.1.2).

8.3 National Instrument 54-101 (2002-2005)

National Policy 41 was amended and recast as National Instrument 54-101 in 2002. Although it was based on the same process and structure as NP 41, it introduced several important substantive changes in the communications process. For the purposes of this paper, the most important of these are:

- intermediaries were required to provide issuers with a NOBO list, allowing issuers to distribute materials directly to their NOBO investors;[68] and
- non-registered investors were no longer entitled to decline to receive materials for meetings at which non-routine business would be considered.[69]

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67 The other two objectives were to "…ensure that the obligations of each participant in the communication chain are equitable and clearly defined:" and to "…ensure that regulation and procedure is uniform nationwide".

68 NI 54-101 introduced the terms NOBO and OBO. Non-registered investors already had the ability under NP 41 to determine whether they wished to be identified to the issuer, but NP 41 did not use the terms OBO and NOBO.

8.4 Amended National Instrument 54-101 (2005 to Present)

As noted above, NI 54-101 was amended in 2005. For the purpose of this paper, the most significant of these amendments are:

- the definition and form of legal proxy were amended to clarify that a beneficial owner may designate a person to have voting power under the legal proxy; and
- non-registered investors were permitted to decline to receive all proxy-related materials or to receive only proxy-related materials relating to meetings where shareholder approval of fundamental changes to the issuer is being sought.

8.5 Proposed Amendments to NI 54-101

In the fall of 2007, CSA staff began their review of how NI 54-101 currently works in practice. The CSA conducted its own research and engaged in consultation with issuers, intermediaries, beneficial owners, a proxy advisory firm, proxy solicitors and service providers, both individually and through an advisory group. The comment period closed on August 31, 2010. The most significant amendments being proposed are:

- adoption of a notice-and-access regime (discussed at Section 26.3 of this paper);
- simplification of the process by which investors appoint proxies (discussed at Section 27.6.2 of this paper);
- enhanced disclosure about the beneficial owner voting process (discussed at Section 34.2 of this paper); and
- stricter rules on use by third parties of NOBO information and the indirect sending procedures (discussed at Section 24.3.3 of this paper).

[69] NP 41 allowed non-registered investors to elect not to receive materials relating to annual or special meetings of security holders, or audited financial statements.

PART III – HOW THE SYSTEM WORKS

9 How the Indirect Holding System Operates

In most cases, shares (and other securities) in Canada are held through an "indirect holding system".

The indirect holding system is a clearance and settlement system[70] that allows investors to execute trades quickly through their brokers. This section describes the way in which shares are introduced, entered, and traded within this system. A key concept to keep in mind in connection with this discussion is that shares are "fungible". In other words, one share in a class (and series) is exactly the same as another share of the same class (and series) and therefore it does not matter to an investor that it be able to associate its investment with any particular share.

9.1 How Shares Enter the Indirect Holding System

When an issuer offers securities to the public for the first time, it engages one or more registered dealers to sell those shares on its behalf by way of a prospectus.[71] This is the "primary market".

In connection with the offering, the issuer applies to CDS for an ISIN or CUSIP number,[72] which provides a unique identifier for the class (or series) of shares. When shares are issued on the closing of the offering, CDS becomes the registered holder of the shares. A single share certificate bearing the ISIN number (the "global" or "jumbo" certificate) may be issued to CDS. CDS is referred to as a "depository"[73] because it simply holds the shares on behalf of others and provides a clearing and settlement service for the trades in those shares. At this point, there is only one registered shareholder – CDS. Over time, investors may elect to hold their interest in registered form;[74] however, when the offering closes, CDS will typically be the single registered shareholder.

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70 "Clearing" involves matching the buy and sell orders to confirm the terms of trade. "Settlement" involves delivery of the share position and payment for the trade between participant accounts.

71 Securities laws will require the issuer to file a prospectus providing full, true and plain disclosure about the securities and the issuer to prospective purchasers. Securities laws do not generally permit issuers to sell securities directly to the public – the securities must be sold through registered dealers (unless an exemption to the registration requirement is available).

72 CDS uses International Security Identification Numbers ("ISIN") to identify the securities that are eligible for processing in its systems consistent with the International Standards Organization's ("ISO") international standard for numbering securities. CDS is the national numbering agency for ISINs, which are created by applying the CA country code for Canada as a prefix and a check digit as a suffix to CUSIPs, which are assigned by Standard & Poor's. CUSIPs are comprised of nine characters comprised of a six-character issuer code, a two-character sequence code or maturity date formula code and a check digit.

73 CDS is the only recognized depository in Canada. See Section 14 for further discussion.

74 Unless the shares are held in the book-entry only system. See Section 9.3.

At closing, CDS holds the shares registered in its name on behalf of those "participating brokers" who sold the shares on behalf of the issuer to the broker's clients under the offering. There are approximately 100 participants in the CDS system. About half of these are various financial institutions, such as banks and trust companies as well as foreign depositories and the Bank of Canada. The rest are dealers and are referred to as "participating investment dealers". Typically four to eight of these dealers will act as underwriters in connection with a public offering of shares. When an issuer creates a new issue registered in CDS's nominee name, it will, through its transfer agent, issue a global certificate to CDS or increasingly will just create the new position in its register to reflect CDS as the registered holder.[75] CDS will credit on its book-entry registration and transfer system the number of shares represented by position on the issuer's register or, if issued, on the global certificate, which it holds for each of the dealers who acted as underwriters in the offering.[76] The dealers, in turn, credit on their own books the accounts of their respective clients to whom they sold shares under the offering. Those clients may be the ultimate investors, or there may be other intermediaries (other brokers, custodians) who hold on behalf of their own clients. The process of book-entry notations continues down the chain of intermediaries until the party that actually paid for the shares (the investor) is reached.[77] No one in this chain—other than CDS which has an ownership interest in the shares registered in its name—is entitled to receive share certificates or is considered to be the registered owner of those shares.

There is no legal requirement for the offering to start in the book-based system. This is simply the process that has evolved as a result of market demands for efficient trading. The following diagram illustrates the process:

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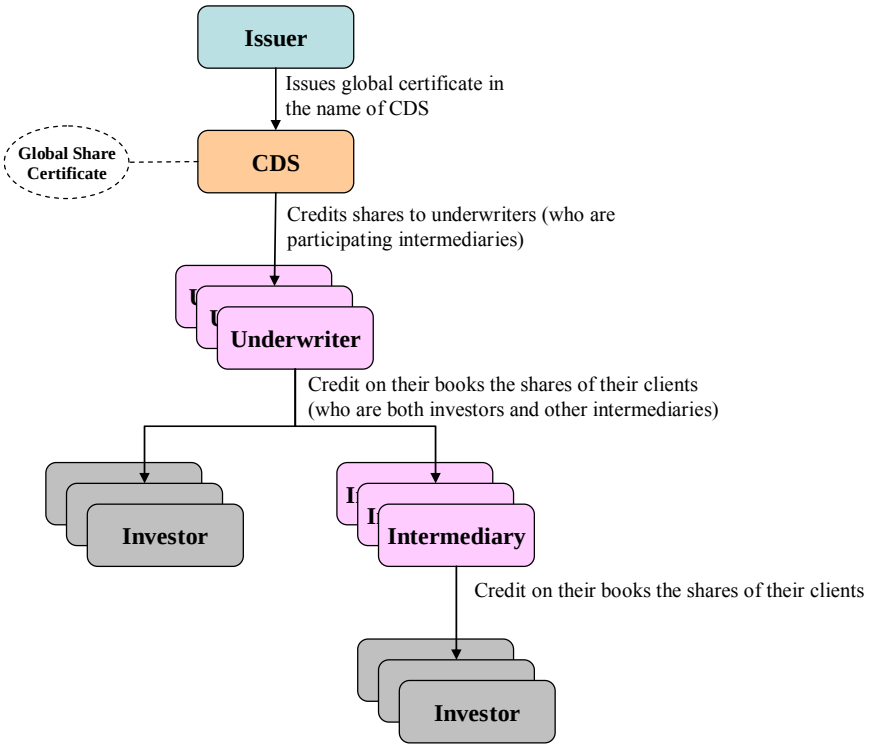
[75] With the dematerialization of securities discussed in Section 4.2.2, CDS will eventually cease to hold physical share certificates.

[76] These are referred to as "direct participants". DTC and other depositaries such as the Japan Securities Depository Center Inc. are participants in CDS and can act as an intermediary for clients located in other jurisdictions.

[77] In certain circumstances, a beneficial owner will hold its share through a nominee corporation or trust.

Diagram 1:How Shares Enter the Book-Based System



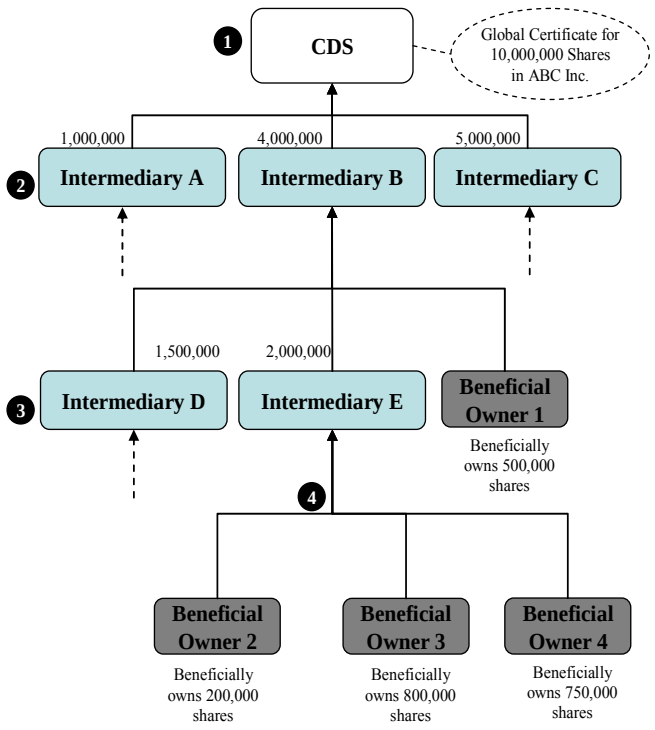
9.2 How Shares Are Traded in the Book-Based System

Once shares have been issued (i.e. the offering has closed) investors may buy and sell an interest in those shares in the "secondary market". Issuers facilitate trading in the secondary market by listing their securities on a stock exchange. In Canada, there are three stock exchanges for equity securities. The TSX accepts listings for companies that satisfy its minimum listing requirements, which vary by industry. The TSX Venture Exchange ("TSX Venture") serves the public venture capital market and lists securities of early stage issuers seeking growth capital who may not meet all of the listing requirements of the TSX. In order to list on an exchange, an issuer must enter into a listing agreement with that exchange and comply with the listing requirements on an ongoing basis. Finally, CNSX Markets Inc. operates the Canadian National Stock Exchange which offers reduced barriers to listing and serves as an alternative stock exchange for micro and small cap companies in Canada.

Most trades in the secondary market are reflected on the books of brokers through whom the investors hold their interests. For example, if Investor A sells an interest in 100 shares and Investor B acquires an interest in 100 shares, each of their accounts with their brokers will be adjusted to reflect this transaction. The issuer has no involvement in the transaction and will generally not know who made the trade, although they are often aware of significant trading activity.

A broker's interest as recorded on the books of CDS is the aggregate of all of the shares which it holds on behalf of its clients or as principal. Only net changes in the broker's position are recorded at CDS. For example, if Investor A and Investor B in the previous example have the same broker, that broker's position at CDS will not change as a result of the trade. However, if A and B have different brokers (and assuming no other transactions), CDS will adjust its records to show that Broker A holds 100 fewer shares and Broker B holds 100 additional shares. A more detailed example is included in Diagram 2 below:

Diagram 2: Share Trades in the Book-Based System



This diagram depicts a situation where a reporting issuer, ABC Inc., issues 10,000,000 shares in registered form through the book-based system. The shares are represented by a Global Certificate.

In this example:

1. CDS is the registered holder of the global certificate representing 10,000,000 common shares in the capital of ABC Inc.
2. CDS, as depository, credits on its book-entry registration and transfer system, the accounts of direct participants who hold a position with respect to the shares of ABC Inc. In this case, the records of CDS would credit: (a) 1,000,000 shares to Intermediary A; (b) 4,000,000 shares to Intermediary B; and (c) 5,000,000 shares to Intermediary C.
3. Intermediary B holds 4,000,000 shares on behalf of three clients and credits the following number of shares to their respective accounts on its book-entry system: (a) 500,000 to Beneficial Owner 1; (b) 1,500,000 to Intermediary D; and (c) 2,000,000 to Intermediary E. These interests would not be reflected on the book-entry registration and transfer system of CDS since neither Beneficial Owner 1, Intermediary D or Intermediary E is a direct participant in CDS's book entry registration and transfer system. While Intermediaries A and C also hold shares on behalf of their respective clients (who comprise other intermediaries and/or beneficial owners), for purposes of this example, only Intermediary B is considered.
4. Of the 2,000,000 shares held by Intermediary E, 250,000 are held in its own inventory (in its capacity as beneficial owner). The remaining 1,750,000 are credited to the accounts of three clients: (a) 200,000 to Beneficial Owner 2; (b) 800,000 to Beneficial Owner 3; and (c) 750,000 to Beneficial Owner 4. While Intermediary D would also hold on behalf of its clients (who comprise other intermediaries and/or beneficial owners), for purposes of the example, only Intermediary E is considered.

In this example, if Beneficial Owner 2 sells 100,000 shares to Beneficial Owner 3 and there are no other share transfers, the records of Intermediary E would be revised to reflect the fact that Beneficial Owner 2 now holds 100,000 shares and Beneficial Owner 3 holds 900,000 shares. However, the aggregate position of Intermediary E on the books of Intermediary B remains unchanged at 2,000,000 shares. If, however, Beneficial Owner 2 sells the 100,000 shares to Beneficial Owner 1, the records of Intermediary B would have to be adjusted to reflect the fact that Intermediary E's aggregate position had dropped from 2,000,000 to 1,900,000 shares and Beneficial Owner 1's position had increased by 100,000 shares to 600,000. There would be no change in Intermediary B's CDS account balance since its aggregate position remains unchanged at 4,000,000 shares. If, however, the trade had been with a beneficial owner whose account was with Intermediary C, there would be a net settlement in the CDS accounts of Intermediary B and Intermediary C with Intermediary B's account being reduced by 100,000 shares and Intermediary C's account being increased by 100,000 shares.

It is possible for a trade to "fail" in the sense that the person with the authority to deliver the shares (typically an intermediary) fails to do so. This is often outside of the control of the intermediary who was required to deliver the shares. Its own client might not have delivered the shares to it, for example, or it might not have been able to acquire the securities required for delivery in the marketplace. In almost all cases, the sale will eventually settle – typically within about four days of the expected settlement date.[78]

78 The Investment Industry Regulatory Organization of Canada [IIROC], "Recent Trends in Trading Activity, Short Sales and Failed Trades" (February 2009), online: <http://docs.iiroc.ca/DisplayDocument.aspx?DocumentID=DE2E6F9F4AE442F5BC0AE75A9E812FE5&Language=en>. IIROC studied failed trades for the period of May 1, 2007 to September 30, 2008 and found that failed trades in Canada accounted for 0.27% of the total number of trades executed. The IIROC study notes that the predominant cause of failed trades was administrative delay or error (including

Very often the intermediary who sought to purchase the securities on behalf of its client will credit its client's account with the purchased securities on the settlement date even when there has been a failure on that date. If the loan continues through a record date, then the purported purchaser of the securities will receive a meeting notice and a request for voting instructions, as will the seller. As a result, the votes associated with the position may be voted twice.

9.3 Book-Entry Only System

Dematerialization refers to the elimination of physical share certificates. Securities transfer legislation (discussed below) facilitates dematerialization by giving the investor enforceable property rights in the securities entitlement in which it has invested, making physical possession of share certificates unnecessary. Both the SEC and CSA have studied the issues relating to the elimination of physical certificates, but have not enacted any regulation relating to the issue.[79] In the United States, the SEC and DTC require new issues to be eligible for the Direct Registration System (DRS), whereby investors can choose to have their securities registered directly on the issuer's register in book-entry form (i.e., no certificate is issued).

No statutory or regulatory action has occurred in Canada. However, CDS has stated that it is committed to dematerialization, of which the introduction of the "book-entry only" ("BEO") system is a first step.[80] If an issuer opts to use the BEO system for the issuance of securities, either a single global share certificate is issued in the name of CDS or no physical share certificate is actually issued; a book entry is made instead. In either case, the result is that all shares must be registered exclusively in the name of CDS (or its nominee) on the register of the issuer. Accordingly, that issuer's investors lose the ability to have any securities of that issuer registered in their own names. For the purposes of this paper, the BEO system will have little impact on the process by which issuers communicate with their investors, other than eliminating the need to communicate with registered shareholders. A BEO issuer will have a single shareholder on its register. All other investors will be OBOs or NOBOs.

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inadvertent delays related to obtaining physical securities certificates, custodians lacking instructions and discrepancies related to security price/amount), which accounted for almost 51% of fails. In all, IIROC found that less than 6% of the fails resulted from short sales (accounting for only 0.07% of total short sales). The average failed trade was ultimately settled in 4.2 days after the "expected settlement date" with 96% of failed trades settled within 10 days after the expected settlement date.

79 Securities and Exchange Commission, Concept Release: Securities Transactions Settlement, 69 Fed. Reg. 12922 (2004); 17 CFR Part 240 and *Discussion Paper 24-401 on Straight-Through Processing*, O.S.C. CSA Request for Comment, (2004) 27 O.S.C.B. 3977.

80 More recently, CDS has introduced other measures to eliminate the issuance and holding of certificates, such as a trust indenture that allows debt to be issued in uncertificated form, conversions of equity certificates to non-certificated inventory with the support of the transfer agents, enhanced system functionality and fees for new issues that are deposited in certificated form.

As discussed in Section 10.3.3, there are certain key statutory rights under corporate law that may be exercised only by registered shareholders, such as the right to requisition a meeting, to make a proposal and to attend meetings and to vote. Investors in a BEO issuer will have no ability to put their interest into registered form. This does not, however, mean that such investors are not able to exercise those rights. Though no one has that ability (other than CDS), the BEO Issuer Procedures, which are a part of the BEO Security Services Agreement signed by issuers that deposit their issues at CDS, require the issuer to accept instructions from CDS on behalf of its participants (who are giving CDS instructions at the behest of their clients, the beneficial owners). Although there is nothing in the documentation entered into between the issuer and CDS to effect the BEO relationship between them that requires CDS to put the beneficial owners in the same position as the registered holder, CDS responds to requests from beneficial owners (or, more often, their legal counsel or the CDS participant representing them) in respect of effecting security holders' rights, such as requesting that a shareholder meeting be convened.[81]

10 The Legal Relationships

The legal system has adapted in a number of important ways to accommodate the book-based system and the fact that the investors are seldom the registered holders of the shares in which they invest. The law creates a series of legal relationships intended to give the investor many of the rights it would have if it was the registered shareholder. This section discusses the legal rights and obligations of the registered holders, the intermediaries and the investors.

A note about nomenclature:

- *Registered holders* are the persons shown on the issuer's shareholder register (which is maintained by the issuer's transfer agent).
- *Intermediary* refers to anyone who holds shares on behalf of someone else. CDS is both a registered holder and an intermediary. Brokers, banks and custodians are intermediaries with respect to interests that they hold for their clients.

[81] The CDS BEO documentation provides that CDS "shall not be liable for nor shall it be deemed to assume any other responsibilities" not set out in the BEO documentation. Section 12 of the BEO Issuer Procedures, however, states that the issuer is bound to accept instructions – via notice - from CDS on behalf of beneficial owners in respect of the beneficial owner's interests. While Section 12 does not impose any obligation on CDS to effect such communication, in practice, security holders can, and often have, requested that CDS transmit instructions or requests on behalf of the ultimate beneficial owners. In order to ensure that liability for such instructions does not fall on CDS, participants are obliged to indemnify CDS for taking action based on such instructions. This indemnity is a critical aspect of the contractual relationship between CDS and its Participants (and is set out in the CDS Participant Rules), but CDS practice has been to require explicit acknowledgement of the indemnity for each instruction transmitted.

- *Investor* refers to the person who made the investment in the shares and would generally be referred to as the "shareholder"[82] to distinguish the investor from beneficial holders of the shares who in turn hold for someone else's benefit. The investor is referred to in corporate and securities law as the "beneficial holder" and in securities transfer legislation as the "entitlement holder". In fact, however, every person in the chain of interest between the issuer and the investor has a beneficial interest in the shares in question (and so are beneficial holders).

10.1 Registered Holders

As noted above, *registered holders* are the persons shown on the shareholder register (which is maintained by the issuer's transfer agent). In Canada, only about 15 percent of publicly traded securities are registered in the name of the investor; the remaining 85 percent are held indirectly through the book-based system.[83]

An issuer is generally entitled to treat the registered owner of a security as the person exclusively entitled to exercise all the rights and powers of the owner of the security (including the right to vote, to receive notices, to receive interest, dividends or other payments in respect of the security).[84] The issuer need not concern itself with whether the registered holder holds the share on behalf of a third party (a beneficial holder).[85] This, of course, makes sense because the issuer will have no way of knowing that someone shown on its register holds the shares on behalf of someone else. When a share is sold, the purchaser is entitled to have that transfer reflected on the shareholder register[86] if it provides the necessary documentation to the issuer. However, if the purchaser does not do so, the issuer will continue to deal exclusively with the person shown on its register.

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82 This is not a legal term, but rather is the term being used in this paper to distinguish the person from others in the chain of interests. We do not use the term "beneficial owner" because that term can apply, under various statutes, to the intermediaries as well. For example, CDS holds "for the benefit of" its participants and therefore those participants are beneficial owners. A participant may in turn hold for another intermediary (such as a custodian) who in turn holds for the person who actually made the investment in the shares. The term "investor" is also more descriptive of the relationship between that person and the issuer.

83 Broadridge presentation dated 19 April 2010, on file with authors, at 10. According to a 2010 CDS presentation entitled "Going Paperless in the Canadian Securities Market" at July 31, 2009, 7% of the share certificates in CDS's vaults represented BEO securities.

84 CBCA, s. 51(1).

85 CBCA, s. 51(4).

86 Where securities are held in the BEO system (discussed in Section 9.3 above), the purchaser will not be entitled to have the transfer registered.

10.2 Intermediaries

10.2.1 Dealing with the Right to Vote

As noted above, an *intermediary* is anyone who holds shares on behalf of someone else. CDS is both a registered holder and an intermediary. Brokers and custodians are intermediaries with respect to interests that they hold for their clients.

Many of the provincial business corporations' statutes address only the rights of the registered shareholder and do not deal with the obligations of intermediaries to facilitate the investor's right to enjoy the benefits attached to the share in which it has invested.[87]

The CBCA does, however, impose a number of obligations on the intermediary.[88] The CBCA will not allow an intermediary to vote a share unless two conditions have been satisfied. First, the intermediary must send the proxy materials to the beneficial owner on whose behalf the intermediary holds that share. Any person who solicits a proxy (whether management or a dissident) must provide to the intermediary a sufficient number of copies of its proxy materials to allow the intermediary to fulfill this obligation. Second, the intermediary may not vote a share unless it receives written voting instructions from the beneficial holder.[89]

Securities laws impose extensive requirements on intermediaries as part of the communication process. However, not all intermediaries who play a role in the Canadian capital markets are subject to Canadian laws. For example, sub-custodians are often foreign banks that clear through a Canadian custodian. These sub-custodians, particularly in Europe, are under no legal obligation to respond to the custodian's request for information on the beneficial holders or to mail materials to the beneficial holders (although in some cases they do). The issuer will often provide materials to intermediaries outside of Canada, even if the entity is not a CDS or DTC participant. However, these entities are outside the reach of Canadian laws, and so little can be done to force these entities to participate in the way Canadian securities laws mandate intermediaries to participate in the process.

10.2.2 Dealing with Other Rights Associated with the Shares

While corporate and securities law requirements address the obligations of intermediaries to facilitate the exercise by investors of the voting rights attached to shares in which they have invested, corporate law is completely silent on the other property rights of the investor in such shares and the ability of the investor to assert such rights against an intermediary. The common law also did not provide any clear answers as to the nature of such rights. It is only recently, with

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87 A comparable provision to CBCA, s. 153 is not present in the corporate statutes of six of the 14 jurisdictions.

88 Similar obligations are imposed on dealers and mutual fund custodians under certain securities legislation (see, for example, *Securities Act* (Ontario), R.S.O. 1990, c. S.5, s. 49 [OSA]).

89 Securities transfer legislation, discussed in the next paragraph, provides that the intermediary must exercise voting rights and other rights of ownership of the securities as directed by the entitlement holder.

the enactment of the *Securities Transfer Act*[90] ("STA") (and similar legislation in other provinces), that the legal rights of investors have been defined in Canada.[91]

Securities transfer legislation describes the proprietary interest of an investor as a "security entitlement". The security entitlement gives the investor certain rights by requiring that the intermediary, through which the entitlement is held, must:

- pass through to the investor any distributions on, or payments made in respect of, the securities;[92]
- exercise voting rights and other rights of ownership of the securities as directed by the investor (the STA does not deal with the mechanics of how this is to be done in practice);[93]
- transfer or otherwise deal with its position in the securities, to the extent of the investor's interest, at the direction of the investor;[94]
- convert its position in securities, to the extent of the interest of the investor and at the direction of the investor, into any other available form of securities holding, such as obtaining a securities certificate; [95] and
- maintain at all times, a match between its position in the securities and the claims of its clients.[96]

10.3 Investor

10.3.1 What Does the Investor Own?

As discussed above, an investor has no legal relationship with the issuer. Only a registered holder has rights directly against the issuer (with the exception under some statutes of the rights of beneficial holders to make a proposal). Corporate law has therefore primarily dealt only with the transfer of shares in registered form, not with the rights of investors who own shares through an intermediary like a broker.[97] These rights, as described in section 10.2.2 above, may generally be asserted by an investor only against the intermediary.[98]

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90 *Securities Transfer Act*, S.O. 2006, c. 8, proclaimed in force January 1, 2007 [STA].

91 Most of the provinces of Canada have adopted legislation that is substantially similar to the STA or are in the process of doing so. Because the STA is closely based on Revised Article 8 of the *Uniform Commercial Code* ("UCC"), Canadian law relating to securities transfers is now not only generally consistent across the provinces of Canada, but consistent with the law in the United States as well.

92 STA, s. 99.

93 STA, s. 100.

94 STA, s. 101.

95 STA, s. 102.

96 STA, s. 98.

97 *E.g.,* Part VII of the CBCA, which is typical of the prior law in Canada. These provisions were similarly based on an earlier version of Article 8 of the UCC. They were first adopted in Canada in the 1970 *Ontario Business Corporations Act*, which was the first modern Canadian statute of its kind. As many Canadian

Although an investor's security entitlement, as defined by securities transfer legislation, is a form of property interest, it does not give the investor a claim against the underlying securities. A securities entitlement is treated as a property interest in order to ensure that securities positions held by the intermediary on behalf of investors are not exposed to claims by other creditors of the intermediary.[99] The investor is exposed to the risk[100] that there may be a shortfall between the claims of all the intermediary's clients and the intermediary's financial assets available to satisfy such claims.[101] However, if an investor acquires its security entitlement from the intermediary for value and without notice of adverse claims, it is protected from liability to any adverse claimant.[102]

Because an investor can generally assert rights in respect of a securities entitlement only against the intermediary with whom the holder deals, securities transfer legislation does not change the position of the investor with regard to the right to vote.[103] An investor is able to exercise voting rights only through the provisions of securities legislation discussed in detail below.

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provinces adopted corporate statutes based on the CBCA by the 1980s, very similar securities transfer rules were therefore in place for the securities of most Canadian corporations.

98 STA, s.7(3).

99 STA, s. 97(1).

100 This risk may be mitigated by recourse to the investor protection fund – Canadian Investor Protection Fund (CIPF) in Canada and Securities Investor Protection Corporation (SIPC) in the United States.

101 Only in very limited circumstances can an investor enforce its securities entitlement against a purchaser of financial assets from the intermediary, where there is a shortfall on the insolvency of the intermediary: STA, s. 97(4), (7).The *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 contains a special Part XII dealing with securities firm bankruptcies. Part XII is generally compatible in its approach with the STA. In particular, if there is such a shortfall, only an investor who holds "customer name securities", such as securities registered in the investor's name, will be able to claim 100% of the securities in the investor's account.

102 STA, s. 96. This extends to investors the protection already provided to registered shareholders by corporate law. This is of course necessary in order to provide certainty, predictability and finality in routine transactions occurring with great frequency in the public markets. Corporate law dealing with securities transfers was based on the premise that transfers of investment securities should be treated in the same way as negotiable instruments. (In Canada, "bills of exchange and promissory notes" are under federal jurisdiction (*Constitution Act, 1867* (U.K.), 30 & 31 Vict., c.3, reprinted in R.S.C.1985, App. II, No. 5 at s. 91.18). The law relating to them is codified in the *Bills of Exchange Act*, R.S.C. 1985, c. B-4, and the *Depository Bills and Notes Act*, S.C. 1998, c. 13. The latter statute deals with bills and notes held in the book-based system). This meant that the delivery of a security certificate in accordance with the practices followed in securities markets should convey good title to the security to an innocent purchaser for value, notwithstanding defects in the title of the transferor or any predecessors in title. In other words, it reversed the common law principle that a seller cannot give better title to a purchaser than it has itself.

103 STA, s. 64(1) preserves the long-standing rule that "an issuer…may treat the registered owner as the person exclusively entitled, (a) to vote…". This section was cited by the Court in *Northwest Value Partners Inc. v. Bell* (2009), 97 O.R. (3d) 511 (S.C.J.) at 517, in holding that an REIT was not obligated to recognize instruments signed by the beneficial owners of units purporting to remove the trustees because the registered unitholder was CDS and the beneficial owners had not taken the necessary steps to register the units in their names or obtain similar instruments signed by CDS.

10.3.2 The Right to Submit Proposals

A shareholder proposal is a matter which is put before a meeting of shareholders at the initiative of one or more shareholders. The proposal may include the nomination of an individual to be elected as a director. In order to submit a proposal, an investor (whether it is the registered or beneficial owner) must satisfy certain ownership criteria.[104] If the person who submits the proposal fails to continue to satisfy this criteria up to and including the date of the meeting, then for a period of two years after the date of that meeting, any proposal made by that person will not be included in any management circular.[105]

Under some Canadian corporate legislation, only a registered shareholder may submit a shareholder proposal. Both the CBCA and the OBCA extend this right to beneficial shareholders as well. This change in the statutes resulted from a 1996 Supreme Court decision[106] that applied a strict interpretation of the statutory provision that referred only to registered shareholders as having the right to submit a proposal. The court noted, however, the "evolution of extensive beneficial holdings, and the movement towards granting to beneficial shareholders many of the rights traditionally enjoyed by registered shareholders, with respect to promoting active shareholder participation in corporate governance." The next set of amendments to both the CBCA and the OBCA extended to the beneficial holders the same right with respect to shareholder proposals as existed for registered shareholders.[107]

In general the courts have given strict interpretation to the corporate law provisions that require the issuer to recognize only the registered holder of its shares as having the right to cast the votes attaching to those shares.

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104 The investor must have held an interest in at least 1% of shares of the issuer or shares of the issuer with a market value of at least $2,000 for at least six months prior to the day before the shareholder submits its proposal (or must have the support of other investors who meet those requirements in the aggregate). *Canada Business Corporations Regulations, 2001*, S.O.R./2001-512, s. 46.

105 *Dodd-Frank Act, supra* note 15.

106 *Verdun v. TD Bank,* [1996] 3 S.C.R. 550.

107 The new measures in the CBCA were aimed at improving the rights of shareholders. The legislature sought to improve and modernize the law by increasing shareholders' right to communicate among themselves and encouraging their participation in the corporation's decision making process. The legislature also sought to clarify the responsibilities of directors and shareholders. See *Debates of the Senate (Hansard)*, 1st Session, 37th Parliament, Volume 139, Issue 6 (8 February 2001) (Hon. Céline Hervieux-Payette).

10.3.3 Rights Reserved to Registered Shareholders

None of the Canadian corporate statutes, other than Alberta's, extend to beneficial shareholders the right to requisition a meeting of shareholders. This right is reserved for registered shareholders of not less than five percent of the issued shares of the corporation.[108] In order to get the benefit of this right, one or more investors holding not less than five percent of the issued shares that carry a right to vote must put their interests into registered form.[109] The right to make, repeal or change the issuer's by-laws is also reserved for registered shareholders and may not be exercised by investors.[110]

It makes little sense that investors (as beneficial owners) have the right to nominate directors and submit other matters to a meeting of shareholders, but do not have the right to requisition the meeting at which those matters would be considered or even to attend that meeting. Furthermore, as discussed in Section 9.3, as more and more share issuances are effected through the BEO system, any rights reserved for the registered holders of an issuer's shares will become completely unexercisable by investors (since they will not have the option of becoming registered holders of the shares in which they have invested).

10.3.4 Disclosure Obligations of Investors

Investors are subject to a number of disclosure obligations under corporate and securities laws because a beneficial interest in securities is included in a number of important concepts in this legislation.[111] For example, in determining whether a person controls an entity or is a subsidiary, affiliate or associate of an entity, that person's beneficial ownership of securities of that entity will be included. Shares held beneficially are also included in determining whether a person is an insider, and therefore whether that person is subject to any restrictions and reporting requirements imposed on insiders. The take-over bid and early warning provisions of the securities laws are triggered by a person's beneficial ownership in the shares of the issuer in question.

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108 CBCA, s. 143.

109 Because the BEO system requires that all shares be registered exclusively in the name of CDS, the BEO system will render this illusory.

110 Under CBCA, s. 103(5), a shareholder entitled to vote at an annual meeting of shareholders may, in accordance with s. 137, make a proposal to make, amend or repeal a bylaw.

111 Investors as described in this paper are beneficial owners of the shares in which they have invested for the purposes of the corporate statute. "Beneficial ownership" includes ownership through an intermediary – CBCA, s. 2(1). Securities laws do not define the concept of "beneficial ownership" in this context.

PART IV– PARTICIPANTS IN THE PROXY VOTING SYSTEM

11 Accountability Issues

11.1 Importance of Accountability in the Proxy System

A number of organizations are involved in the proxy voting system. It is important to understand who plays a role in this process because in many situations there is some degree of discretion that must be exercised by the participants. To understand the accountabilities in the system, one must understand who is making decisions and to whom the decision-makers are accountable.

11.2 Accountability Through Regulation

Regulation is one form of accountability. Some of the organizations which play a role in the proxy voting system are regulated (e.g. issuers, brokers, transfer agents) and some are not (e.g. proxy agents, meeting chairs, proxy solicitors, proxy advisory services).

One key concept that is important for the purpose of this discussion is the concept of the "market participant". The issuer, CDS, the brokers and the transfer agents are market participants under securities laws. Securities law provides that one of the primary means for achieving the purposes of the Act is "…requirements for the maintenance of high standards of fitness and business conduct to ensure honest and responsible conduct by market participants."[112] A number of specific provisions flow from being a market participant, among them:

- the OSC may order such examination of the financial affairs of a market participant as it considers expedient "…for the due administration of Ontario securities laws or the regulation of capital markets in Ontario;"[113]
- market participants are required to keep books and records for the proper recording of their business transactions and financial affairs and the transactions they execute on behalf of others and must provide them to the Commission on request; and[114]
- the Commission may make an order "…that a market participant submit to a review of his, her or its practices and procedures and institute such changes as may be ordered by the Commission."[115]

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112 OSA, s. 2.1. This section also provides that "Business and regulatory costs and other restrictions on the business and investment activities of market participants should be proportionate to the significance of the regulatory objectives sought to be realized."

113 OSA, s. 12(1).

114 OSA, s. 19(1) and (3). The Commission may also conduct a comprehensive compliance review of these books and records under section 20.

115 OSA, s. 127.

The fact that an organization is regulated should not be seen as the answer to all issues. We tend to want to think of regulators as being responsible for everything when we wish to rely on them, and to resist regulation where it negatively affects our own businesses. It is important to understand where the mandate for regulation currently exists, whether it is currently being executed effectively and whether there are changes to the mandate or to the execution that are desirable.

11.3 Accountability Through Contract

Privity of contract is also a form of accountability. Where those who are responsible for a process are accountable by contract to those who are affected by the process, the terms of that contractual relationship will affect the dynamic.

12 Issuers

Issuers are "market participants" for the purposes of securities laws and are, of course, subject to the provisions of their governing statutes. Partnerships (including limited partnerships) and trusts have little, if any, of the statutory infrastructure that governs corporate issuers. Provisions similar to those found in the corporate statutes are typically imported to a greater or lesser extent into the partnership agreement or declaration of trust and some may be imposed by securities laws (such as the proxy requirements under Part XIX of the OSA or the investor consent requirements of NI 81-102 applicable to material changes in mutual funds).[116]

13 Investors

13.1 Retail Investors

Retail investors are non-institutional investors who invest in securities for their own accounts. One of the major issues relating to retail investors is their engagement in the voting process. Many do not vote. There is a concern that the pending move to the notice-and-access regime as a delivery method will further discourage retail investors.

13.2 Institutional Investors

Institutional investors include pension funds, custodians, banks, mutual and other fund managers and others who invest funds belonging to others.

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[116] *Mutual Funds,* O.S.C. NI 81-102, (2000) 23 O.S.C.B. (Supp.) 59 (28 January 2000, as amended effective 28 September 2009).

On the institutional side, one of the leading issues is the institution's fiduciary duty in connection with proxy voting. Canadian securities laws require investment funds to establish policies and procedures to determine whether and how to vote the shares of its portfolio issuers. The fund must maintain a proxy voting record on an annual basis and must send a copy of the policies and procedures and voting record without charge to any investor upon request. The fund must also post the proxy voting record on its website if it has one.[117] Similarly, federal pension regulations and most provincial regulations require pension administrators to maintain a proxy voting policy, and OFSI guidelines recommend one, but none provide specific detail about the contents of the policy or the procedure for voting proxies.[118] The Ontario Teachers' Pension Plan, one of the largest institutional investors, has a mandate to vote all shares of the issuers in which it invests and pledges to exercise voting rights in the manner that most enhances the long-term value of its plan's investments.[119] In the United States, fund managers are required to vote proxies with the same diligence as making other fund decisions.[120] The SEC has also put a rule in place to address potential conflicts of interest which may influence a fund manager's proxy voting decision.[121]

14 Canadian Depository for Securities

14.1 What Is CDS?

CDS (the Canadian Depository for Securities) is Canada's central depository for securities and the only "recognized depository" for the purposes of Canadian securities laws.

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117 *Investment Fund Continuous Disclosure*, O.S.C. NI 81-106, (2005) 28 O.S.C.B. 4911 (1 June 2005, as amended effective September 8, 2008) at Part 10.

118 See e.g. *Pension Benefits Standards Regulations 1985*, S.O.R./87-19, s.7.1(1)(f); Office of the Superintendent of Financial Institutions, *Guideline for the Development of Investment Policies and Procedures for Federally Regulated Pension Plans* (OSFI: Ottawa, April 2000), online: <http://www.osfi-bsif.gc.ca/app/DocRepository/1/eng/pension/guidance/penivst_e.pdf>.

119 See Ontario Teachers' Pension Plan, *Statement of Investment Policies and Procedures* (23 June 2010) at s. 10, online: <http://docs.otpp.com/sipp.pdf>.

120 In 1988, the U.S. Department of Labor issued a set of guidelines, known as the "Avon Letter," directing *Employee Retirement Income Security Act* (ERISA) fund managers to vote proxies with the same diligence as making other fiduciary decisions. See Letter from Alan D. Lebowitz, Deputy Assistant Sec'y, Dep't of Labor, to Helmuth Fandl, Chairman of the Ret. Bd., Avon Prods., Inc. (23 February 1988), in 15 Pens. Rep. (BNA) 391 (1988). ERISA fund managers deal with proxies on securities held in employee benefit plan investment portfolios and the maintenance of and compliance with statements of investment policy, including proxy voting policy. The Department formalized its policies in an interpretive bulletin in 1994. See Interpretive Bulletin Relating to the Employee Retirement Income Security Act of 1974, 29 C.F.R. § 2509.94-2 (1994), amended by 29 C.F.R. § 2509.08-2 (2008).

121 On January 31, 2003, the SEC adopted rule 206(4)-6 and amendments to rule 204-2 to the *Investment Advisers Act of 1940*, 15 U.S.C. § 80b-1 (Release No. IA-2106/IC-25922). Under rule 206(4)-6, it is a fraudulent, deceptive, or manipulative act, practice or course of business within the meaning of section 206(4) of the Act for an investment adviser to exercise voting authority with respect to client securities, unless (i) the adviser has adopted and implemented written policies and procedures that are reasonably designed to ensure that the adviser votes proxies in the best interest of its clients, (ii) the adviser describes its proxy voting procedures to its clients and provides copies on request, and (iii) the adviser discloses to clients how they may obtain information on how the adviser voted their proxies.

Two-thirds of CDS[122] is owned by Canada's six major chartered banks;[123] the rest is owned by the TSX and the IIROC. Through its subsidiaries, CDS plays a variety of roles in the shareholder voting process; however, in this paper, we are focusing on CDS's role as depository. CDS, through its subsidiaries, operates the System for Electronic Document Analysis and Retrieval ("SEDAR"), the National Registration Database ("NRD") and the System for Electronic Disclosure by Insiders ("SEDI") on a for-profit basis and under a contract with the CSA.

14.2 How Is CDS Regulated?

The activities of CDS are highly regulated, both federally and provincially. The CDSX has been designated as a clearing and settlement system under the *Payment Clearing and Settlement Act*[124] ("PCSA") and so comes under the oversight of the Bank of Canada. This reflects the importance of the clearing and settlement function to Canada's financial system and the need for these systems to be properly designed and operated in order to control risk to the financial system in Canada and contribute to its stability.[125] In accordance with its "Guidelines Related to the Bank of Canada Oversight Activities under the *Payment Clearing and Settlement Act*",[126] the Bank of Canada enters into agreements with the clearing and settlement system covering aspects such as netting arrangements, risk control and risk-sharing mechanisms, certainty of settlement, finality of payments, notice requirements, operational and financial soundness, and any other matter related to systemic risk of the clearing and settlement system. The Guidelines also provide minimum standards that a designated system is expected to meet. Lastly, the guidelines outline the principles and procedures that the Bank of Canada intends to follow in regard to identifying eligible clearing and settlement systems, determining whether an eligible system is exposed to systemic risk, deciding whether an eligible system should be subject to the PCSA and dealing with cross-border issues arising from clearing and settlement systems.[127]

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122 CDS is a CBCA corporation.

123 As at October 31, 2009, the banks (The Bank of Montreal, The Bank of Nova Scotia, The Toronto Dominion Bank, The National Bank of Canada, The Canadian Imperial Bank of Commerce and The Royal Bank of Canada) owned 66.7%; IIROC owned 15.2%; and the TSX owned 18.1% of CDS's shares (according to CDS's NI 58-101F1 filed in January 2010). It has been suggested by some stakeholders that the ownership of CDS by major banks that also own several of the major intermediaries might predispose CDS to see matters from an intermediary point of view and that perhaps CDS would benefit from an independent perspective.

124 *Payment Clearing and Settlement Act*, S.C. 1996, c. 6 [PCSA]. Under s. 4(1), the Governor of the Bank of Canada may designate a clearing and settlement system (which is defined to mean "…a system or arrangement for the clearing or settlement of securities transactions…where the system also clears or settles payment obligations arising from those transactions…" CDS was so designated most recently in 2003. See Miscellaneous Notices (Bank of Canada), C. Gaz. 2003. I. 983.

125 To this effect, the preamble to the PCSA states that "Parliament recognizes that it is desirable and in the national interest to provide for the supervision and regulation of such clearing and settlement systems in order to control risk to the financial system in Canada and promote its efficiency and stability."

126 Bank of Canada, "Guideline Related to Bank of Canada Oversight Activities under the *Payment Clearing and Settlement Act*" (updated November 2002), online: <http://www.bankofcanada.ca/en/financial/guide2002.html#five>.

127 *Ibid*.

In Ontario, CDS is regulated by the Ontario Securities Commission ("OSC") and as a clearing agency by the OSC, pursuant to section 21.2 of the *Securities Act* (Ontario).[128] In Québec, the Autorité des marchés financiers ("AMF") regulates CDS and authorizes CDS to carry on clearing activities.[129] Both acts provide broad discretionary powers to the OSC and to the AMF in the regulation of clearing agencies. CDS reports as required to the CSA, an umbrella organization of provincial and territorial securities regulators.[130]

14.3 What Does CDS Do?

CDS operates the clearing and settlement system in Canada and has the authority to establish rules governing the system that are valid notwithstanding any statute or other federal or provincial law.[131] This power to override other statutes – particularly statutes of other jurisdictions – is quite extraordinary, but illustrates the importance to the economy of an effective clearing and settlement system. CDS settles over 30 million cross-border transactions annually with the United States and has custodial relationships with the DTC, Euroclear France, Japan Securities Depository Center, Inc. ("JASDEC") and Skandinaviska Enskilda Banken ("SEB").[132]

Federal protection of securities regulations allows CDS to act as a custodian of securities for federally incorporated institutions, such as banks, trust and loan companies, insurance companies and pension funds.[133]

Although CDS is the only recognized depository in Canada, there are depositories in other jurisdictions. Where issuers' shares are held in more than one jurisdiction, more than one depository will hold an account with respect to these shares. The depository in the United States is DTC.

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128 OSA.

129 See Sections 169 and 170 of the *Securities Act* (Québec), R.S.Q. c. V-1.1. See also *Recognition Order*, O.S.C., (17 October 2006). See also *Authorization Decision*, A.M.F., Bulletin vol. 3 no. 42 (20 October 2006).

130 Bank of Canada, "Payment and other clearing and settlement systems", online: <http://www.bank-banque-canada.ca/en/financial/financial_other.html>.

131 PCSA, s. 8.

132 See CDS, "About CDS clearing", online: <http://www.cds.ca/cdsclearinghome.nsf/Pages/-EN-Profile?Open>.

133 See CDS, "Regulatory environment", online: <http://www.cds.ca/cdsclearinghome.nsf/Pages/-EN-Regulatoryenvironment?Open>.

15 Intermediaries

15.1 Who Are Intermediaries?

15.2 Brokers

Brokers provide investment advice to, and execute trades on behalf of, their clients and are market participants for the purpose of Canadian securities law. Securities legislation and the IIROC rules impose a variety of requirements on brokers through the universal registration system.[134] These requirements relate to, among other things, capital, proficiency, recordkeeping, conflicts of interest and custody of clients' assets. The securities regulators have broad powers of oversight. Compliance audits are conducted to ensure that market participants are keeping proper records and regulators may conduct investigations into matters they consider to be related to the due administration of the capital markets.[135]

Brokers are also subject to rules imposed by two self-regulatory organizations ("SROs"): the TSX and the IIROC. The TSX regulates brokers by limiting access to trading to qualified persons as prescribed by the TSX Rules.[136] The TSX Rules also contain general trading rules that regulate the trading activity of its participants.[137] Most of the substantive trading rules and restrictions under the TSX Rules have been repealed; the TSX now relies mainly on securities legislation and the Universal Market Integrity Rules ("UMIRs") under the IIROC.[138]

The IIROC regulates brokers through a system of registration requiring proficiency examinations and a designated training period with an the IIROC-member firm.[139] the IIROC regulates market integrity using the UMIRs to control various trading practices, including manipulative methods of trading, short selling, front running and best execution obligations.[140] the IIROC also engages in market surveillance to try to ensure compliance with the UMIRs.[141] In addition, the IIROC regulates its members using its Dealer Member Rules and Conduct and Practices Handbook, which deal with matters such as business conduct, minimum records, trading and delivery, capital and margin requirements, audit requirements and educational requirements.

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134 *Registration Requirements and Exemptions*, O.S.C. NI 31-103, (2009) 32 O.S.C.B. (Supp. 4) 1 (28 September 2009).

135 See for example OSA ss. 20 and 11.

136 Toronto Stock Exchange Rule Book and Policies, Rule 2-101 [TSX Rule Book].

137 TSX Rule Book, Division 4.

138 TSX Rule Book, Rule 4-201.

139 IIROC Dealer Member Rules, Rule 2900.

140 IIROC Universal Market Integrity Rules, generally.

141 TMX, "Market regulation", online: <http://www.tmx.com/en/trading/rules_regulations/market_regulation.html>.

Brokers play a number of different roles in respect of the matters discussed in this paper:

- they may be CDS participants;
- they are intermediaries with respect to shares they do not hold for their own account; and
- to the extent they are CDS participants, they are, by definition, "proximate intermediaries"[142]. In addition, brokers who hold their interests in registered form are also proximate intermediaries.

It is important to note that, for the retail investor, the broker is typically the first (and often the only) point of contact. Investment dealers and advisors are not only regulated in the matter of shareholder communications and voting matters, but have an ongoing relationship with clients to meet their needs in this regard. If the system "fails" the investor, the advisor is generally the first person who receives a call and the person who is generally tasked with dealing with a frustrated or disenfranchised investor and trying to find a solution.

15.3 Custodians

Certain investors hold their investments through custodians, whether for administrative convenience or in response to legislative requirements. Pension benefits legislation typically restricts who may administer a pension fund to certain entities.[143] Mutual fund regulations similarly require that all portfolio assets of a mutual fund must be held by a custodian that meets certain requirements.[144]

Canada is one of the few jurisdictions that does not regulate persons who provide custodial services. However, in Canada, all of those providers are banks or trust companies and are therefore subject to the legislative requirements applicable to such institutions and to the oversight of the Office of the Superintendent of Financial Institutions ("OSFI") or provincial regulators.[145] Despite this, there is little, if any, specific oversight of the custodial activities offered by these institutions.

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142 This is a term of art used in NI 54-101.

143 See, for example, *Pension Benefits Act* (Ontario), *General Regulation*, R.R.O. 1990, Reg. 909, s. 54. The *Income Tax Regulations* (Canada), C.R.C., c. 94, s. 8502(g)(6)(3) also provides that a pension fund must be administered by certain entities.

144 NI 81-102, s. 6.2.

145 The following firms provide custodial services in Canada: Canadian Western Trust, CIBC Mellon Global Security Services Company, Desjardins Trust, J.P. Morgan Worldwide Securities Services, National Bank Trust, The Northern Trust Company, RBC Dexia Investor Services, and State Street Trust Company Canada.

In carrying out their custodial services, these organizations undertake all of the administrative functions associated with the shares in their custody, such as making sure dividends are received, keeping track of meeting dates, and ensuring that their clients receive voting materials. The administration and oversight of securities lending programs are also among the services offered by custodians.

Custodians handle large volumes of securities. Twenty years ago, the Canadian custodial services were provided by 14 trust companies and securities departments of major banks. In the 1990s, large U.S.-based global custodians entered the Canadian marketplace. Their more sophisticated technology made them better able to respond to demands from plan sponsors that were growing as a result of increasingly global portfolios.[146] Today, the Canadian marketplace is primarily served by four providers: State Street, RBC Dexia, CIBC Mellon and Northern Trust. RBC Dexia is a joint venture between Royal Bank of Canada and Dexia. CIBC Mellon is a joint venture between CIBC and BNY Mellon. State Street and Northern Trust are both U.S.-based global custodians.[147]

16 Proxy Agents (Broadridge)

16.1 What Are Proxy Agents?

The term "proxy agent" is not a term of art (it is not used in NI 54-101, for example). It is a generic term used to describe parties to whom intermediaries outsource their responsibilities in connection with the proxy voting system. Virtually every intermediary in Canada uses Broadridge as its proxy agent.

16.2 Broadridge

Broadridge is a U.S. public company[148] with a market capitalization of $2.5 billion. It provides proxy distribution and voting services for North American and global issuers. On a global scale, Broadridge's systems deliver proxy materials for approximately 13,000 shareholder meetings annually, reaching beneficial shareholders through 90 million investor accounts at over 900 financial intermediaries.

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146 Tom MacMillan, "15 Years of Change: A Brief History of the Canadian Custody Industry" *Benefits and Pensions Monitor* (December 2006), online: <http://www.bpmmagazine.com/02_archives/2006/december/15_years_canadian_custody_industry.html>.

147 NI 81-102, s. 6.2 deals with the entities that are qualified to act as custodian or sub-custodian for assets held in Canada.

148 Broadridge was spun off from ADP Investor Communications Services, Inc. in 2007.

Broadridge started its business in Canada in 1987 specifically to support issuers and intermediaries in complying with NP 41, the first securities regulation that governed shareholder communications with beneficial owners. It now operates in Canada under the name Broadridge Financial Solutions, Inc. The part of its business that is relevant to the discussion in this paper[149] is its Investor Communication Solutions. Approximately 98 percent of the intermediaries in Canada have outsourced their responsibilities for delivery of proxy materials and the tabulation of voting instructions to Broadridge. We are advised by both Broadridge and the IIAC that this reflects a well-functioning partnership between Broadridge and its clients in Canada.

16.3 How Are Proxy Agents Regulated?

Proxy agents are not regulated by the securities regulators or any SRO in Canada. Broadridge advises that it is contractually obligated to its intermediary clients to perform the functions outsourced to it by the intermediaries in compliance with NI 54-101, but it is not itself a market intermediary or regulated in any other way. Broadridge advises that it engages Deloitte & Touche to audit and test the accuracy of its processing of voting and reporting of votes cast and that after testing over 130 internal controls, no significant process control design gaps have been observed.

17 Transfer Agents

17.1 Who Are the Transfer Agents?

Transfer agents of public companies are companies that have been retained by the issuer to maintain its share register, cancel and issue share certificates and distribute dividends and to perform other services such as plan administration.[150]

17.2 Requirement to Have a Transfer Agent

The issuer is required under corporate law to maintain a share register. If the issuer has securities listed on the TSX or TSX Venture, it is required to have its share register maintained by an approved transfer agent.

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[149] Broadridge operates two other business segments: Securities Processing Solutions, through which it offers global banks, retail, institutional and discount brokerage firms, and correspondent clearing firms, a range of scalable multi-entity, multi-currency securities processing solutions; and Clearing and Outsourcing Solutions, through which it offers a variety of trade execution, clearing, custody, settlement, operations outsourcing and business expansion services to institutional broker-dealers, discount and full service broker-dealers, and wealth managers.

[150] Issuers also often retain their transfer agent for other functions. For example, transfer agents also act as registrars and will generally serve as scrutineers at annual general meetings and special meetings of shareholders.

Issuers listed on the TSX are required, as a condition of listing, to maintain transfer and registration facilities in the City of Toronto, where all the issued securities of the listed classes must be directly transferable.[151] An issuer with shares listed on the TSX Venture must appoint and maintain a transfer agent and registrar with a principal office in one or more of Vancouver, British Columbia; Calgary, Alberta; Toronto, Ontario; Montréal, Quebec; or Halifax, Nova Scotia.[152] The appointment and any subsequent change of the transfer agent must be approved by the TSX. The TSX will typically allow only trust companies to act as transfer agents,[153] because many aspects of a transfer agent's function are "trust services", which require them to be registered as a trust company.[154] Equity Financial Trust Company,[155] Olympia Trust Company[156] and Valiant Trust Company[157] are other leading transfer agents. There is additional comfort in this status for the TSX since trust companies are subject to regulatory oversight. Computershare[158] and CIBC Mellon[159] are the two largest transfer agents in Canada. Most transfer agents have an interface with CDSX.[160]

17.3 How Are Transfer Agents Regulated?

The function of maintaining the share register is not regulated in Canada. As discussed above, in keeping with TSX requirements, transfer agents are trust companies and fall under either provincial or federal trust company legislation, which includes requirements relating to recordkeeping. They are also "market participants" for the purposes of securities legislation,[161]

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151 TSX Company Manual, s. 347.

152 TSX Venture Exchange Corporate Finance Manual, Policy 3.1, s. 7.2 [TSX Venture].

153 TSX Company Manual, s. 348; TSX Venture, Policy 3.1, s. 7.2.

154 In the United States, section 17A(c) of the *Securities Exchange Act of 1934*, 48 Stat. 881, 15 USC. § 78a [*Exchange Act*] requires that transfer agents be registered with the SEC, or if the transfer agent is a bank, with a bank regulatory agency. The SEC has enacted rules for all registered transfer agents which include minimum performance standards. The SEC also conducts inspections of transfer agents. See Securities and Exchange Commission, "Transfer agents", online: <http://www.sec.gov/divisions/marketreg/mrtransfer.shtml>.

155 Equity Financial Trust Company is owned by Grey Horse Corporation, a TSX listed issuer.

156 Olympia Trust Company is privately held.

157 Valiant Trust Company is a wholly owned subsidiary of Canadian Western Bank, a TSX listed issuer.

158 Computershare is based in Melbourne, Australia and listed on the Australian Securities Exchange. Its website states that it currently provides securities transfer processing, shareholder recordkeeping and issuer services for 65% of companies listed on the TSX. Computershare carries on business in Canada under the name Computershare Trust Company of Canada.

159 In July 2010, CIBC Mellon announced that it has agreed to sell its issuer services business (stock transfer and employee share purchase plan) to Canadian Stock Transfer Company Inc., a subsidiary of Pacific Equity Partners.

160 The following transfer agents have access to certain functions of CDSX related to their roles as transfer agents: Alliance Trust Company, CIBC Mellon Trust, Computershare Investor Services Inc., Computershare Trust Company of Canada, Equity Transfer and Trust Company, Olympia Trust and Valiant Trust Company.

161 OSA, s.1(1), the definition of "market participant" includes "…a transfer agent or registrar for securities of a reporting issuer…"

which makes them subject to recordkeeping requirements[162] and financial examination orders,[163] as prescribed by securities laws. The TSX does not impose requirements on transfer agents.

17.4 STAC

The Securities Transfer Association of Canada ("STAC") is a trade organization of Canadian transfer agents that actively participates in regulatory matters standardizing transfer agent practices in various aspects of their operations. STAC consists of nine members.[164] STAC is not recognized by securities regulators as a self-regulatory organization and there is no publicly available information pertaining to any existing rights and obligations afforded to and required of its members. STAC does however publish some of its agreed standards on its website (www.stac.ca). STAC is also a chapter of the U.S. Securities Transfer Association.

17.5 STAC Proxy Protocol

The STAC Proxy Protocol was initially developed by the members of STAC in 1991 and was updated in 2005 and then again in 2007 to provide guidance to people appointed to review and tabulate proxies and voting instruction forms ("VIFs") for meetings of security-holders. When acting as tabulators, the members of STAC apply the "presumptions" contained in the STAC Proxy Protocol unless the issuer's governing statute, articles or bylaws provide otherwise or unless factual evidence rebutting any of such presumptions is presented to the scrutineer or overruled by the meeting's chair. The STAC Proxy Protocol applies the general presumption in favour of accepting a proxy and effecting a security holder's intentions, whenever possible.

18 Tabulators and Scrutineers

18.1 Function of the Tabulator

Any person in the system who collects, validates and counts votes (or voting instructions) is a tabulator. This includes, for example, intermediaries or Broadridge on their behalf. The final tabulator collects, validates, reconciles and reports votes received from all of the other tabulators along with proxies received from the registered shareholders. The scrutineer is then responsible for reconciling and tabulating any additional votes received (in person, or if applicable, by proxy) at the meeting. The scrutineer also prepares and distributes ballots, should the vote require one, or should a shareholder demand one, and then validates and reports the results of any ballots conducted.

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162 OSA, s. 19.

163 OSA, s. 12.

164 The members of STAC are Alliance Trust Company, Capital Transfer Agency Inc., CIBC Mellon Trust Company, Computershare Investor Services, Eastern Trust, Equity Transfer & Trust Company, Olympia Trust Company, Trans Canada Transfer Inc. and Valiant Trust Company. Any corporation recognized or approved by a Canadian stock exchange that transacts business, wholly or partly, as a transfer agent or registrar for securities of Canadian corporations is eligible for membership in STAC.

18.2 Who Acts as Tabulator and Scrutineer?

The role of final tabulator and scrutineer is typically performed by the issuer's transfer agent, although Broadridge also offers these services.

In Canada, the scrutineer is the person or company hired to supervise and oversee the conduct of voting at the meeting. In practice, this is typically the tabulator, as many transfer agents will refuse to act as the scrutineer if they have not also acted as the final tabulator.

The scrutineer is appointed when the chair of the meeting formally presents that person to the shareholder meeting.

19 Meeting Chairs

The meeting chair is typically the chair of the board of the issuer. In contentious situations, an independent chair is sometimes appointed.

The chair of the meeting makes the final decision on a variety of matters relating to the meeting, including whether a particular vote should be counted. There is no statutory requirement for the meeting to be run in this way, but it is a matter of common law.

20 Proxy Vote Advisory Firms

20.1 Function of the Proxy Advisory Firms

An institutional investor's portfolio will typically include positions in a range of issuers held through a number of different accounts with a variety of intermediaries. The mechanics of tracking record dates and proxy cut-off times, analyzing proxy materials, making voting decisions and then casting the votes, can require significant resources. Many institutional investors prefer to outsource some or all of those functions to a third-party provider referred to as a "proxy advisory firm" or "proxy advisor". In Canada, Institutional Shareholder Services ("ISS") and Glass Lewis & Co. LLC ("Glass Lewis") are the most commonly used proxy advisory firms.

For the purposes of this paper, it is helpful to look at the functions performed by the proxy advisory firms in two categories. One is management of the proxy voting process through their "vote agency services." Among other things, a proxy advisory firm consolidates and manages all of the proxy materials to which an investor is entitled, making sure the investor receives (and therefore has the opportunity to vote) proxies or VIFs for their total position. The proxy advisory firms also offer a voting platform to facilitate the voting, recordkeeping, reporting and disclosure requirements of their clients. All of these functions are performed using the proxy advisor's own proprietary technology.[165]

[165] Some institutional investors use ProxyEdge® or the Consolidated Data Feed solution offered by Broadridge to manage the proxy process.

The other function performed by proxy advisory firms is the provision of research and voting recommendations. A proxy advisory firm will typically have a proxy voting policy which sets out the basis of its voting policies on matters that routinely come before a shareholder meeting or which might affect the view that an investor has of management. In addition, the proxy advisor reviews the circulars for individual meetings and issues reports setting out its analysis and recommendations, as well as recommendations based on its clients' custom proxy voting policies. Because proxy advisory firms are providing these services to many institutional investors, their opinions can be very influential.

Institutional investors use the services of a proxy advisory firm in a variety of ways, three of which are set out below.

20.1.1 Research and Recommendations Only

Some institutions purchase research from one or more providers. While one of these providers may also be the vote agency service for the investor, providing the automated vote instruction via its voting platform, the investor reviews multiple sources of information prior to the transmission of vote instructions for some or all of its ballots.

20.1.2 Proxy Advisor Analysis and Recommendations Integrated Into Ballots as the Default Vote Instruction

In some cases, upon evaluation of the proxy advisor's guidelines and approach to conducting its analysis, investors will determine that the advisor's policy and approach are in line with their own guidelines and can enable them to exercise their fiduciary responsibilities with respect to voting proxies. The evaluation and approval of a proxy advisor's policy typically involves one or more of the following: the proxy committee, fund board, compliance officer, chief operating officer and portfolio managers. If an investor chooses to vote in accordance with the proxy advisor's policy and recommendations, the investor has the ability to review and override the advisor's recommendations prior to votes being cast or to re-vote up until the vote cut-off time. Most investors elect to review and approve voting instructions for high-profile meetings, meetings at companies where they have significant holdings or meetings with key issues on the agenda, such as a merger, contested director election or compensation issues.

20.1.3 Custom Analysis and Recommendations Integrated Into Ballots as Default Instruction

In addition to creating their own analysis and recommendations, proxy advisory firms increasingly provide investors with custom analysis and recommendations based on an investor's policy. In some cases, the policy and recommendations may be in line with that of the advisory firm. In other cases, it will differ. As with the service that features the advisory firm's recommendations as the default, investors also have the ability to review and override recommendations, as well as re-vote, prior to cut-off time.

Unless the investor is voting manually or is using the basic ProxyEdge® voting service from Broadridge, neither of which feature integrated recommendations from third-party providers, investors typically elect to have a set of recommendations integrated at the proposal level on each ballot as a default instruction (either the advisor's standard recommendations or custom recommendations developed by an advisory firm based on the client's policy). In addition to providing its proxy advisory firm with directions on policy preferences, an investor also typically instructs the proxy advisor as to how and when they want the right to review and approve instructions prior to voting.

20.2 Who Are the Proxy Advisory Firms?

20.2.1 ISS

Institutional Shareholder Services ("ISS") was founded in 1985 and is the largest proxy advisory business in Canada. It is a business unit of U.S.-based MSCI Inc.

ISS provides institutional investors with corporate governance consulting and proxy voting advice, as well as financial research and analysis. ISS provides these services to both institutional investors and corporate issuers through two major business divisions. The Institutional Proxy Advisory serves ISS's institutional clients. ISS Corporate Services serves ISS's corporate issuers.

20.2.2 Glass Lewis

Glass, Lewis & Co., LLC ("Glass Lewis") is a more recent entrant into the proxy advisory market. Founded in 2003, Glass Lewis is the world's leading independent provider of governance services, including proxy research, custom policy implementation, vote execution, reporting and regulatory disclosure. (Like ISS, Glass Lewis provides proxy advisory services to institutional investors. However, unlike ISS, Glass Lewis does not offer corporate governance advice or compensation design tools to directors and managers of public companies.) The firm, a wholly-owned independent subsidiary of the Ontario Teachers' Pension Plan since 2007, serves more than 650 institutions worldwide from offices in San Francisco, New York, Paris, Tokyo and Sydney.

20.2.3 SHARE

SHARE is a Vancouver-based organization founded in 2000. Services include proxy research and voting recommendation services to institutional investors. SHARE provides a number of "responsible investment services" designed to help investors integrate environmental, social and governance issues into their investment management process. These services include proxy voting, shareholder engagement, consulting services, policy advocacy and research.

20.2.4 Other Providers

There are two other proxy advisory firms based in the United States that do not yet appear to have a strong presence in Canada.

Egan–Jones Proxy Services was established in 2002 as a division of Egan–Jones Rating Company. PROXY Governance, Inc. ("PGI") was established in 2004, and is a wholly-owned subsidiary of FOLIO*fn*, Inc.

PGI is in the process of re-evaluating its business model with a view to moving to a new model supported not only by user fees, but also by third-party sponsorship. This funding model would allow PGI to make some aspects of its services available to investors free of charge. It would also offer a voting platform free of charge to individual investors and on a discounted user-fee basis to institutional investors. Its own governance would be headed by a board of governors which would include representation by investors, issuers and directors.

20.3 Regulation of Proxy Advisory Firms

The functions of a proxy advisor as described in this paper are not regulated under Canadian securities law. An "adviser" is someone who advises as to the investing in or the buying or selling of securities.[166] The functions of a proxy advisor as we have described them in this paper do not include advising their clients whether or not to buy or sell securities, but are confined to advising their clients on how to exercise rights that attach to securities those clients already own. This is different from the way in which this function is treated in the United States, where the term "investment adviser" includes someone who issues reports concerning securities as part of a regular business.[167] Some proxy advisory firms (MSCI/ISS, for example) are registered with the SEC.

In addition, the function of providing proxy voting advice is specifically excluded from the definition of a proxy solicitor in Canadian securities law.[168]

21 Proxy Solicitation Services

Proxy solicitation firms assist the person who is soliciting proxies by identifying and contacting investors and encouraging them to vote their shares in favour of the party soliciting the proxies. An issuer often retains a proxy solicitation firm if it expects a meeting to be controversial or contested. However, majority voting, say on pay and approval of stock option plans have made shareholder votes much less routine. As a result, issuers are increasingly retaining proxy solicitation firms on a more regular basis, some even on a retainer basis in order to be able to consult with the proxy solicitor throughout the year. "Dissidents" (persons other than management who solicit proxies) will often also retain proxy solicitation firms.

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166 OSA, s. 1, "adviser" means a person or company engaging in or holding himself, herself or itself out as engaging in the business of advising others as to the investing in or the buying or selling of securities.

167 The U.S. *Investment Advisers Act of 1940* at s. 80b–2(a)(11) defines "investment adviser" to include one who "for compensation and as part of a regular business, issues or promulgates analyses or reports *concerning* securities".

168 *Continuous Disclosure Obligations*, O.S.C. NI 51-102, (2004) 27 O.S.C.B. 3439 (30 March 2004) at s. 1.1(1), providing that "solicit", in connection with a proxy, does not include any person acting on behalf of a securityholder as a client, who gives financial, corporate governance or proxy voting advice in the ordinary course of business and concerns proxy voting advice—if the firm discloses any potential conflicts of interest, receives remuneration only from the client, and is not given on behalf of a proxy solicitor; *Canada Business Corporations Regulations, 2001*, S.O.R./2001-512, s. 68(1)(c); *Business Corporations Act Regulation* (Ontario), R.R.O. 1990, Reg. 62, s. 29.2(3).

Proxy solicitation firms work with management or dissidents to ensure that as many votes favourable to their clients' recommendations are cast and counted. These firms review the search process to confirm that the correct number of proxy materials are ordered (and mailed); identify investors who hold a large position on the record date; create an initial vote projection; and advise on the best solicitation approach for major institutional and other key investors. They also identify issues that may attract negative recommendations from proxy advisory firms and can advise and negotiate solutions for their clients.

Proxy solicitors will often act as the mailing agent for dissident proxy circulars and will receive and tabulate the dissident votes and pass the aggregate vote result on to the official tabulator. The votes are then reconciled and re-tabulated by the official tabulator.

In Canada, the largest proxy solicitation firms are Georgeson Shareholder Communications Canada Inc. (owned by Computershare), Kingsdale Shareholder Services Inc. (owned by founder Wes Hall), Laurel Hill Advisory Group, LLC (a U.S.-based private company) and Phoenix Advisory Partners, LLC (owned by American Stock Transfer & Trust Company, LLC).

PART V – HOW PROXY MATERIALS ARE DELIVERED TO INVESTORS

22 Approach to Communications Depends on the Type of Investors

How communications between an issuer and any particular investor flow depends on whether that investor is a registered shareholder or a non-registered investor. In the case of non-registered investors, it then further depends on whether the investor is an OBO or a NOBO. Each of these categories of investor is discussed below.

22.1 Communicating With Registered Shareholders

An issuer is able to identify its registered shareholders simply by looking at the shareholder register. It must provide registered shareholders with proxy materials and a form of proxy within the time period prescribed by corporate and securities laws.[169] Issuers typically deliver these materials to their registered shareholders through their transfer agent.

The number of registered shareholders any issuer has obviously varies depending on how large the issuer is, how long it has been a public company and the profile of its shareholder base. However, it would not be unusual for a large issuer that has had public shareholders for many decades to have 100,000 or more registered shareholders. Even an issuer that has become a public company more recently will acquire a number of registered shareholders other than CDS over time for a variety of reasons. For example, participation in a dividend reinvestment plan ("DRIP") may contemplate participants in the plan who are holding shares in their own name at the point they enrol (although under some plans, non-registered investors make arrangements through their intermediary in order to participate). Shares allotted to them under the DRIP will typically be held in trust in the name of a plan administrator and voted in the manner specified by the participants.

Registered shareholders who are intermediaries (i.e., they are holding the shares for someone else) are "proximate intermediaries" for the purposes of the communications process.

22.2 The OBO/NOBO Distinction

The vast majority of investors are non-registered investors – in other words, they hold their interest in the securities through a broker or other intermediary. For the purpose of communications from the issuer, non-registered investors fall into two categories. The first is comprised of investors who object to having their identity disclosed to the issuer (OBOs) and with whom the issuer cannot therefore communicate directly. The other is comprised of non-registered investors who do not object to having their identity disclosed to the issuer (NOBOs) and who the issuer may contact directly if it so chooses.

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[169] These materials must be filed on SEDAR; NI 51-102, s. 9.3.

Overall, Canadian investors are presently split fairly evenly between those who have chosen NOBO status (49 percent) and OBO status (51 percent).[170] These figures are markedly different from 2002 when 80 percent of non-registered investors were NOBOs and only 20 percent were OBOs. One explanation for this change is that under NP 41 (in force from 1987 to 2002), if an investor did not instruct its intermediary to not disclose its identity to the issuer, the investor was deemed to have consented to the disclosure of its name, address and holdings to the issuer or other sender of material. In other words, absent specific instructions to the contrary, non-registered investors were NOBOs (although that term was not used in NP 41). This provision survived in NI 54-101 until it was amended in 2005 to require intermediaries to obtain instructions before an account was opened. There was no longer a default option. However, clients who became NOBOs by default under the prior requirements were deemed to continue to be NOBOs until some positive step was taken to change the status. A study in the United States (where the system is similar) found that once the OBO/NOBO distinction was explained to them, the majority of investors would elect to be NOBOs. About half of those who said they would elect to be OBOs would only do so if there were no cost associated with this status.[171]

Why would an investor object to receiving communications directly from the issuer? In some cases the investor may wish to avoid being contacted by the issuer (or by dissidents) and their proxy solicitors, seeking to influence its vote or by anyone else with access to the list. In other cases, investors (especially institutional investors) wish to remain anonymous to the issuers for a number of reasons. They may be concerned, for example, that their trading patterns will be discernable unless their identity is protected. Intermediaries often prefer that their clients adopt OBO status because this helps them to preserve the confidentiality of their client lists. Some have suggested to us that intermediaries tend to recommend that their clients elect OBO status in order to maintain the greatest possible control over their client list, but the IIAC has advised us that this is not the case.

Because non-registered investors hold their interests through intermediaries, the information about the investors relevant to their position in a security resides with the intermediaries. This includes names and contact information, the number of shares they hold and at least some of their trading history. The system is designed to prevent an issuer from obtaining this information about its OBO investors[172] and the issuer can only obtain certain information about its NOBO investors from the intermediaries. Upon request, intermediaries are required to provide to issuers (and to certain other persons) the name, address, email address (if the investor has provided one to the intermediary), securities holdings, distribution criteria (coding specifying whether they wish to receive all materials, special meeting materials only or decline to receive all communications) and preferred language of communication of each of the issuer's NOBO investors who hold an interest in the issuer's securities through that intermediary.

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170 Statistics provided by Broadridge.

171 See Section 40.4 for a more detailed discussion of this study.

172 We have been advised anecdotally by a number of investors that although they or their organization are OBOs of a particular issuer, they have been contacted by the issuer or a dissident in order to solicit their vote in connection with a particular meeting. Where this is the case, we have not been able to determine how the issuer or dissident was able to determine that this OBO investor has a position in these securities unless the OBO investor has disclosed this information in some way itself.

22.3 How an Investor Elects to be an OBO or a NOBO

An investor declares its choice to be treated as an OBO or a NOBO when it opens an account with its broker or other intermediary. [173] The intermediary is required to provide an explanation of the NOBO/OBO distinction to a prospective client[174] and, before it holds any securities for that client, obtain the client's instructions on various matters, including whether the client wants to be a NOBO or an OBO.[175] The intermediary is required to obtain these instructions whenever it opens an account for a client, although typically an investor is either an OBO or a NOBO with respect to all of its accounts with an intermediary.[176]

23 The Point in Time for Determining Which Investors Vote

23.1 Record Dates

23.1.1 Need for Record Dates

In order for investors to receive their proxy materials, there must be a process to develop a list of those investors and then send the materials to them. On any given day, an issuer's shares may have been bought, sold or loaned and so a list of an issuer's investors has the potential to be out of date as soon as it is created. In order to deal with the fact that the investor base is constantly changing, corporate statutes have developed the concept of "record dates" for registered shareholders to pinpoint who is entitled to vote. The record date establishes with certainty, both for the issuer and for investors, who will be entitled to vote at the meeting.[177] This concept is mirrored in securities regulation for non-registered investors in the "beneficial ownership determination date".

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173 NI 54-101, s. 3.2 requires that prior to opening an account, the intermediary obtain instructions from the client with respect to the matters set out in the "Explanation to Clients and Client Response Form", NI 54-101F1, which includes an election to be classified as an OBO or NOBO.

174 This is done through NI 54-101F1.

175 *Ibid*.

176 It is possible that a client with multiple accounts at a broker could be a NOBO for some accounts and an OBO for other accounts, as the OBO/NOBO election attaches to the account of the client and not to the securities in the account. Often though, the instructions obtained for the first account are applied to subsequently opened accounts. It is also possible for a party such as a money manager to be voting both OBO and NOBO positions, since they will be voting on behalf of a variety of institutional investors, most of whom are likely to be OBOs, but some of whom might be NOBOs.

177 A recent Yukon decision considered the decision of a meeting chair to allow voting of shares that were issued pursuant to the exercise of convertible debentures after the record date. On the basis that the shares issued on conversion did not exist on the record date, the Court would not permit them to be voted at the meeting. *Scion Capital v. Bolivar Gold Corp.*, 2006 YKSC 17.

Under some corporate statutes, there can be two types of record dates for registered shareholders: a notice record date[178] and a voting record date.[179] The function of each of these record dates for registered shareholders, and how they translate under securities regulation into provisions relevant to non-registered investors, is discussed in greater detail below.

23.1.2 Meeting Record Date (Registered Shareholders)

The first record date is the notice record date.[180] The issuer's board of directors must set this record date to occur no more than 50 days (in most cases) and no less than 21 days (in most cases)[181] before the meeting date. It must do this well in advance as the issuer is required to give CDS, the securities commission and the stock exchange notice of the record date at least 25 days before the record date.[182] The board will also provide its transfer agent[183] with this notice. When the issuer delivers these notices, it has set in motion the communication machinery described below. The issuer must give notice of this record date through newspaper advertisements at least seven days before the record date.[184] The transfer agent typically does this on the issuer's behalf.

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178 Referred to in the statutes as "the record date for the purpose of determining shareholders entitled to receive notice of the meeting." See for example, CBCA, s. 134(1)(c). The corporate statutes in Nova Scotia, Prince Edward Island and Quebec do not contemplate the concept of record dates.

179 The statutes refer to this as "the record date for the purpose of determining shareholders entitled to vote at the meeting." See for example, CBCA, s. 134(1)(d).

180 An issuer must fix a notice record date of a meeting. CBCA, s. 74 provides that the directors "may" fix in advance a date as the record date for the purpose of determining shareholders entitled to receive notice of the meeting. NI 54-101, s. 2.1 provides that a reporting issuer that is required to give notice of a meeting to the registered holders of any of its securities "shall" fix a notice record date of the meeting.

181 NI 54-101, s. 2.1 requires the notice record date to be not less than 30 days before the meeting date, but all of the corporate statutes specify 21 days (with the exception of Ontario, which specifies 30 days, and the statutes of Nova Scotia, Prince Edward Island and Quebec which do not provide for record dates for notice of the meeting).

182 NI 54-101, s. 2.2. The notice must also specify the record date and meeting type. The 25 day time period may be abridged pursuant to NI 54-101, s. 2.20.

183 There is no requirement for the issuer to advise the transfer agent, but this occurs as a function of the relationship. In most cases, the transfer agent performs many of the functions for the issuer on its behalf, such as notifying CDS, sending the search requests, etc.

184 NI 54-101, s. 2.2. The notice must also be given to all depositories and filed on SEDAR. In addition, nine jurisdictions in Canada provide in their respective business corporations legislation that if a record date is fixed for a shareholder meeting, notice of the record date must be given not less than seven days before the date so fixed by, *inter alia*, advertisement in a newspaper published or distributed in the place where the corporation has its registered office *and* in each place in Canada where it has a transfer agent or where a transfer of its shares may be recorded. CBCA, s.132(3). The cites for the provisions in the business corporations statutes of the following jurisdictions are as follows: *Business Corporations Act* (Alberta), R.S.A. 2000, c. B-9, s. 133(4); *The Corporations Act* (Manitoba), C.C.S.M. c. C225, s. 128(4); *Corporations Act* (Newfoundland), R.S.N. 1990, c. C-36, s. 220; *Business Corporations Act* (Northwest Territories), S.N.W.T. 1996, c. 19, s. 135(4); OBCA, s. 95(4); *The Business Corporations Act* (Saskatchewan), R.S.S. 1978, c. B-10, s. 128(4); *Business Corporations Act* (Yukon), R.S.Y. 2002, c. 20, s. 135(4).

The shareholders of record on the notice record date will not actually receive the notice of meeting unless they are entitled to vote. This is discussed in Section 23.1.4 below.

23.1.3 Voting Record Date (Registered Shareholders)

Under the CBCA and the corporate statutes in Alberta and British Columbia, the directors are permitted (but not required) to set a voting record date within the prescribed time frame (under the CBCA, not less than 21 days and not more than 60 days before the meeting).[185] This gives the directors the ability to set a voting record date that is different than the notice record date.

23.1.4 Who Gets the Notice and Who is Entitled to Vote

Under most of the corporate statutes, the notice of the meeting is delivered to the registered shareholders who are entitled to vote.[186] The registered shareholders who are entitled to vote are those who appear on a list prepared by the issuer. If a voting record date has been fixed by the issuer's board of directors, then the list is prepared as at that record date.[187] If no voting record date has been fixed by the issuer's board of directors, then the list is prepared as at the notice record date.[188] Under the other statutes (which do not have the concept of a voting record date), the list is prepared as at the notice record date.

Securities regulation mirrors this approach for non-registered investors. The intermediaries are required to generate lists of their clients who have an interest in the issuer's securities as at the "beneficial ownership determination date". This date is typically the record date for both notice of meeting and voting.

23.1.5 Right to Vote for Those Who Become Investors After the Record Date

Some provincial statutes[189] provide that if a person has transferred the ownership of any shares after the record date and the person who acquired the shares establishes ownership of the shares, then the acquiror may vote those shares if certain conditions are met. Accordingly, for issuers incorporated under any of these statutes, the persons entitled to cast the vote associated with a particular share may change after the list of registered shareholders is generated. The transfer agents may be able to reconcile these items and reverse any proxy delivered by the transferring registered shareholder.

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185 The Alberta statute specifies 50 days and the British Columbia statute specifies two months.

186 CBCA, s. 135(1)(a). This is not addressed in the corporate statutes of Nova Scotia, Prince Edward Island or Quebec.

187 CBCA, s. 138(2).

188 CBCA, s. 138(3).

189 Alberta, Manitoba, New Brunswick, Newfoundland, Northwest Territories, Saskatchewan and Yukon.

Although the statutory provision speaks only to registered shareholders, it is not uncommon for non-registered investors who acquire their interest after the record date to indicate that they wish to vote their position. The problem, of course, is that there will seldom be any way to know who the position was acquired from and therefore no way for any voting instruction submitted by that person to be nullified or reversed. We understand that where this issue is presented to the transfer agents by a NOBO and the position to nullify or reverse cannot be identified, the transfer agents will refer the matter to the meeting chair. In some cases, in an effort to ensure that a new investor is not disenfranchised, meeting chairs allow the instructions to be counted without regard to the fact that they will have no way of knowing whether they have effectively allowed a position to be voted more than once.

23.1.6 Timing of Notice Record Date vs. Voting Record Date

In practice, issuers usually set a single date as both the notice record date of the meeting and the record. If the issuer's board were to set two separate record dates, the list of registered shareholders would have to be prepared in connection with the notice record date and separately in connection with the voting record date.

We understand that some issuers and their transfer agents are concerned that if they set a voting record date later than the notice record date of the meeting, they will need to do two mailings. As noted above, there is no legal requirement to do so. However, since the practice is to notify by mail the shareholders and non-registered investors of record on the notice record date, [190] if the voting record date were later, several problems would result. First, issuers would need to deliver proxy materials twice. Second, investors who received the record date mailing might no longer be investors by the time of the meeting. Third, investors who receive the voting date mailing might not have sufficient time to review the materials and vote. Finally, the system would create a risk of double or multiple voting as a result of trading between the notice record date and the voting record dates. Many, but not all, of these issues could be addressed more easily in a paperless system.

The benefit of having a voting record date that occurs later than the notice meeting date is, however, that there is a greater likelihood that the investors who actually vote will still have an economic interest in the issuer on the meeting date. There are, however, some practical limitations on this theory.

[190] Although there is no requirement to do so.

23.1.7 U.S. Developments

The voting record date has been identified in the United States as a means of reducing the number of votes cast by investors who no longer have an economic interest in the issuer because they sold their shares prior to the meeting date. In 2009, the State of Delaware changed its corporate law to allow boards to set a notice record date of the meeting and a voting record date, as is already the case under the CBCA (and in British Columbia and Alberta).[191]

There is as yet little experience with putting this into effect in the book-based system. The barriers to bifurcating the record dates in the United States are similar to those in Canada. The SEC Concept Release discusses two models that could be adopted to facilitate the issuers' use of separate record dates. The first model would require issuers to provide proxy materials (or an information statement) to those who are investors as of the notice record date. This raises a number of questions, including whether a second mailing would be required to investors of record on the voting record date. Under the second model, issuers would be required to provide the disclosure documents to investors on the voting record date, raising a number of other issues, including whether that disclosure should be made public at some point before the voting record date. The SEC has invited submissions on the dual record date process and suggestions for making it workable.

23.2 Period of Time Between the Voting Record Date and the Meeting Date

23.2.1 Could the Period of Time Be Reduced?

Determining how far in advance of the meeting date the voting record date should occur is an interesting issue. On the one hand, the closer the voting record date is to the meeting date, the greater the coincidence becomes between those who are voting and those who are investors on the meeting date.

On the other hand, the complexity of the indirect holding system means that a number of parties are involved in generating the investor list and will therefore need to have the time to discharge their responsibilities. Once the voting record date arrives, Broadridge requires three days in order to produce the lists of beneficial owners as at the record date.[192] Given the costs of printing materials, issuers typically wait for these final numbers. Printing will typically take one to three days and the issuer must have proxy materials in the hands of the proximate intermediaries three business days before the date, which is 21 days before the meeting.[193]

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191 *Ibid*.

192 The current system builds in at least 25 days before the record date for the communications machinery to start up. The period of time before the record date when various actions must be taken does not affect who is entitled to vote. Only the actions that take place on or after the record date affect this entitlement.

193 Then, within three business days (four business days if the material is to be sent by prepaid mail other than first class mail), the proximate intermediaries must send the materials on to their clients. If their clients are other intermediaries, those intermediaries have one business day to send the materials down the chain. Broadridge has the ability to access simultaneously the information of both the proximate intermediaries and those intermediaries who hold through the proximate intermediaries, thus eliminating the steps of the

The voting instructions must then find their way from the investor to the intermediaries or their agent and then be filed with the official tabulator. However, because investors continue to trade their shares, the people who have received the proxy materials may no longer be investors on the date of the meeting. This is not surprising, given that shareholders may receive their materials as much as three weeks prior to the meeting. The corollary, of course, is that those who are investors at the time of the meeting may not have the opportunity to vote. The other issue is the process used by institutional investors to review proxy materials. In many cases, institutional investors take advice from proxy advisory firms when making their decisions about how to vote and votes are submitted using Broadridge's ProxyEdge® service or the Broadridge white label product offered by RiskMetrics.

23.3 Generating the List of Non-Registered Investors on the Record Date

23.3.1 How the List is Generated

The information necessary for an issuer to provide its proxy materials to non-registered investors can only be generated by the intermediaries. Much of the regulatory framework prescribes steps that must be taken in order to cause the intermediaries to generate that information. Although the participants in the system comply with those requirements, in practice, the process operates in a much more streamlined fashion than is contemplated by the regulatory framework.

23.3.2 Information Flow Prior to the Record Date

Under securities regulation, when CDS receives the notice of a record date, it is required to send to the issuer's transfer agent a list of the CDS participants who hold positions in the issuer's voting securities. In practice, the transfer agent does not need to rely on securities regulation to find out what positions are held by which intermediary in any given security. CDS provides this information to the transfer agent on a daily basis as a result of agreements between CDS and the transfer agents which have been put in place to allow the NCI[194] and CDSX systems to operate.[195] Pursuant to those arrangements, CDS gives each transfer agent the participant positions at the close of business each day.

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proximate intermediary sending a request to the other intermediaries and those other intermediaries replying back to the proximate intermediary.

194 This is as a result of the No Certificate Issued ("NCI") environment which CDS and the transfer agents entered into in 1993. CDS surrendered the certificates in its vault to the transfer agents, who cancelled the certificates and provided CDS with a book-entry position on the share register in CDS's nominee name. CDS is required to balance its holdings to the transfer agents' registered positions each day and the transfer agents provide CDS with a file of CUSIPs and closing balances each night, which CDS uses to balance its holdings.

195 This is necessary under CDSX's straight-through processing environment.

The transfer agent[196] sends to the proximate intermediaries[197] and to Broadridge[198] a Request for Beneficial Information.[199] This request is sent at least 20 days before the record date.[200] In response to this request, the proximate intermediaries (and other intermediaries in the chain below the proximate intermediaries) are required, among other things, to generate the information necessary to give the issuer a sense of how many sets of proxy materials it will need to print (and how many will be delivered electronically). They must provide this information within three business days of receiving the Request for Beneficial Information. Other intermediaries in the chain below the proximate intermediaries are required to generate that information from their files and provide it back up the chain, ultimately to the proximate intermediary. The information provided in this response will of course be only an approximation of what will be required on the record date, since the information is delivered over two weeks before the record date and trading will have continued during that period.

In practice, Broadridge eliminates the need for the proximate intermediaries and the intermediaries below them to pass information back and forth because Broadridge is able to communicate not only with the proximate intermediaries, but with virtually all intermediaries. It is able to do this because it has contractual relationships with virtually all of the intermediaries and has built electronic connections and systems to receive the information about the beneficial owners in the systems of both the proximate intermediaries (approximately 70 intermediaries) and the intermediaries who hold through those proximate intermediaries (approximately 260 banks, custodians and brokers).

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196 Under NI 54-101, s. 2.5 these are the obligations of the issuer. However, s. 2.5(4) provides that a reporting issuer must request beneficial information under s. 2.5 through a transfer agent. The proposed amendments to NI 54-101 would also allow the issuer to request this information though Broadridge. (The proposed amendment refers to "another person or company" if both of the following apply: (i) the person or company is in the business of providing services to assist persons or companies soliciting proxies; (ii) the reporting issuer has reasonable grounds to believe that the person or company has the technological capacity to receive the beneficial ownership information. Proposed Amendments to NI 54-101, *infra* note 208 at s. 3.)

197 The proximate intermediaries are the CDS participants who have a position in the issuer's voting securities, together with intermediaries who are registered shareholders. They are the top of the waterfall of intermediaries. Intermediaries who are not proximate intermediaries in theory pass information about their own non-registered investor clients on to the transfer agent through the proximate intermediaries; although in practice, as noted above, Broadridge has the ability to access this information from all of the intermediaries.

198 Although there is no requirement to do so, the transfer agent also sends this request to Broadridge, since in reality it is Broadridge that provides the information on behalf of most of the intermediaries.

199 "Request for Beneficial Ownership Information", NI 54-101F2.

200 NI 54-101, s. 2.5. This is subject to s. 2.20, which allows the issuer to abridge the prescribed time frames if certain conditions are met.

23.3.3 Information Flow With Respect to the Record Date

On or the night before a record date, Broadridge sends an electronic "trigger" to each of the intermediaries (or back-office providers) reminding them of the record date the next day. The intermediaries (or back-office providers) then have two days to respond back to the trigger. On the third day, Broadridge compiles the information and provides to the issuer what is referred to as a Record Date Confirmation, which states how many sets of materials will in fact be required and how many investors have agreed to receive their materials electronically from an intermediary. At that point, Broadridge will also have the contact information for all of the non-registered investors shown on the records of the intermediaries.

There is no regulatory or contractual requirement for Broadridge or the intermediaries to provide this information to the issuer, but they do so in order to promote the efficiency of the system.

24 Who Delivers the Materials

24.1 Delivering Materials to Registered Shareholders

The obligation of the issuer to send proxy materials to registered shareholders is quite straightforward. The issuer sends to the registered holder both the proxy materials and the form of proxy (along with the annual report for those who have requested it and the request card for interim and annual reports). Taking into account the requirements of corporate and securities law, as well as those of the stock exchange, those materials must be delivered between 21 and 60 days before the meeting date.[201]

The communication with registered shareholders is almost always done by the issuer through its transfer agent.[202] The transfer agent is required to provide a certificate of mailing with respect to the registered holders. That certificate is filed and posted on SEDAR.[203] Transfer agents will often also deliver to their clients an Affidavit or Declaration of Mailing, to provide them with sworn assurance that the meeting has been properly constituted.

24.2 Delivering Materials to Plan Participants

Although participants in plans such as DRIPs may have registered positions in the securities of the issuer, the shares allotted to them under the DRIP will typically be held in trust in the name of a plan administrator. Where the plan administrator is also the transfer agent, the transfer agent is able to send proxies representing both their registered positions and their plan shares directly to the participants. Where a third party is the administrator, the process discussed below for providing proxy materials to NOBOs and OBOs applies.

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201 *Canada Business Corporations Regulations*, 2001, S.O.R./2001-512, s. 44; NI 51-102, s. 9.2.

202 Broadridge also offers this service, but does not do a significant amount of this business.

203 SEDAR, "Appendix B: Certificate re Dissemination to Shareholders", online: SEDAR Filer Manual <http://www.sedar.com/sedar/sedar_filer_manual_en.htm>.

24.3 Delivering Materials to NOBOs

24.3.1 Who Delivers Materials

Materials may be delivered to NOBOs either by the issuer (through its transfer agent) or by the intermediaries (through Broadridge).[204] It is the issuer that decides on the delivery option.

If the issuer wishes to deal with its NOBOs directly, it requests a NOBO list from Broadridge (on behalf of the intermediaries). The issuer pays a fee for that list and, of course, incurs the cost of delivering materials to the NOBOs. If the transfer agent delivers to the NOBO investors, the transfer agent includes confirmation of the NOBO mailing in the Affidavit of Mailing that is provided to the issuer.

If the issuer prefers to have the intermediaries (through Broadridge) deliver the materials to the NOBOs, the issuer pays a fee to Broadridge plus the actual cost of sending the materials.

The fees charged by Broadridge are discussed in Section 42.4 below. At this point we note only that there is at least a perception on the part of some that the fees Broadridge charges are such that many issuers will find it more cost effective to retain Broadridge for both the OBO distribution and the NOBO mailing. When the transfer agents do the NOBO mailings, they generally agree to charge the same $1 per record as Broadridge charges, including the cost of obtaining the NOBO list. However, we understand that Broadridge charges different fees when it does only the OBO mailing as opposed to when it does the OBO and NOBO mailing.

24.3.2 Use of the NOBO List[205]

NOBO lists can be generated at any time, but they may not be used other than for matters relating to the affairs of the issuer.[206] For the issuer, this includes delivering proxy materials and proxies, offering documents, non-proxy mailings (such as interim financial statements) and other investor relations communications.

Third parties may also request a NOBO list and may wish to do so, for example, in connection with a take-over bid. However, concern has developed that allowing third parties to access a NOBO list in connection with any other matter relating to the affairs of the corporation may allow some to use the NOBO list for matters beyond the intended scope of the provision. For example, in a 2005 decision, an Alberta court considered whether a person in the business of connecting lost shares with their rightful owners (for a fee) could access and use the NOBO list

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[204] Under Securities and Exchange Commission (SEC) rules, companies mainly communicate with beneficial owners through broker or bank intermediaries. Intermediaries are prohibited from disclosing to a company the identity of beneficial owners who object to that disclosure (objecting beneficial owners or OBOs), and the company cannot contact OBOs directly. The company may contact directly shareowners who do not object (non-objecting beneficial owners or NOBOs), but SEC rules nonetheless require that proxy materials be forwarded to them by the intermediaries.

[205] The provisions discussed here also apply to the response by a depository to a request for an intermediary search.

[206] This includes sending proxy materials, efforts to influence the voting by investors, an offer to acquire securities of the issuer, or "any other matter" relating to the affairs of the issuer: NI 54-101, s. 7.1.

for this purpose. It held that the provision should be interpreted broadly, with an emphasis on the relationships between the parties, and not on the motive for the use of the information.[207] Access to the NOBO list was granted.

24.3.3 Proposed CSA Amendments

Concern with abuse of the NOBO list has led the CSA to propose an amendment to section 7.1 of NI 54-101. Under the proposed amendments, the reporting issuer would be permitted to use a NOBO report in connection with any matter relating to the affairs of the reporting issuer. All other persons would be restricted to using the NOBO list to send proxy materials, in an effort to influence a vote or in respect of an offer to acquire securities of the issuer.[208]

24.4 Delivering Materials to OBOs

24.4.1 Who Delivers Material to OBOs

An issuer may not communicate directly with its OBOs. It may do so only through passing those materials down the chain to the investor. Virtually all intermediaries in Canada outsource their responsibilities to Broadridge by having them deliver materials and tabulate votes received from their OBOs.[209] As noted above, Broadridge receives the relevant information from virtually all of the intermediaries (not just the proximate intermediaries) and so is able to deliver proxy materials directly to the non-registered investors.

Broadridge does not provide to the issuer an Affidavit of Mailing as the transfer agents do with respect to the mailing to the registered shareholders (and in some cases the NOBO investors). However, Broadridge advises that it does offer the issuers access to a website that tracks the status of the issuer's mailing through to its delivery to Canada Post. One question that should be asked is whether the mailing date reported is the date on which the first piece of mail was sent or when the full mailing was complete.

24.4.2 Why Some OBOs Do Not Receive Their Materials

When securities regulation first developed the OBO concept, it attached a price to the anonymity that OBOs were able to claim – that price being the cost of delivering proxy materials to them. While the issuer is responsible for the cost of mailing to its registered investors and to its NOBOs, it is not required to pay the fee or the delivery costs in connection with the delivery of proxy materials to OBOs who have indicated that they wish to receive proxy materials. [210] The

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207 *Encana Corp. v. Douglass*, 2004 CarswellAlta 1973 (Alta. Q.B). Note that this case considered CBCA, s. 21(9). Those provisions are comparable to NI 54-101, s. 7.1.

208 *Proposed Amendments to NI 54-101*, O.S.C. Notice and Request for Comments, (2010) 33 O.S.C.B. 3109 at s. 20 [Proposed Amendments to NI 54-101].

209 There are a few intermediaries who complete their own proxy processing.

210 The issuer will know how many OBOs are affected because the intermediaries (through Broadridge) advise the issuer of how many OBOs (and their proximate holdings) will not receive proxy materials unless the OBO or the issuer pays the cost of delivery, NI 54-101F2 at Item 10.

cost that this notionally imposes on OBOs has been likened to the cost of having an unlisted phone number.

The theory that OBOs would pay these costs has not been borne out in practice because intermediaries do not typically pass these costs through to their clients. In many cases, intermediaries do not have the systems in place to do so. Even if the systems were in place, intermediaries are often reluctant to impose this additional cost on their clients. However, if the intermediary simply chooses not to deliver the materials, it is in breach of its obligations under NI 54-101. Still, the marketplace and the regulators seem to have come to accept that if neither the issuer nor the intermediary is prepared to absorb the costs, the OBOs in question will simply not receive their proxy materials.

In practice, the great majority of issuers absorb the costs of delivering proxy materials to OBOs who wish to receive them, even though they are not required to do so.[211] Where the issuer declines to absorb the costs, intermediaries will most often do so, [212] either as part of the their client service policy or as part of their contractual obligations to larger, usually institutional, holders. In doing so, they obviously forgo the fee that is otherwise paid by the issuer to Broadridge on behalf of the intermediaries. However where neither the issuer nor the intermediary is prepared to pay the costs, the intermediary will simply not deliver the proxy materials to the OBO, rather than absorbing the costs themselves or requiring the OBO to pay those costs.[213]

There are several consequences that flow from not delivering proxy materials to OBOs who wish to receive them. Most importantly, those OBOs are disenfranchised and the issuer is deprived of the benefit of the views of all of the investors that wished to vote. In addition, there may be a potential that an issuer could strategically elect not to pay for delivery to OBOs where it thinks that a lower voter turnout would be more favourable to the management position. Finally, depending on the issuer's quorum requirements, low voter turnout could result in an issuer failing to achieve quorum.[214]

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211 Broadridge reports that in 2010, 1,423 issuers (37% of issuers) declined to pay for mailing to OBOs. Broadridge *National Instrument 54-101 Statistics & Securityholder Communications Trends – 2010 Update.*

212 Comment Letter from the IIAC to CSA, "Regarding Proposed Amendments to National Instrument 54-101" (30 August 2010) stating that the intermediaries absorbed the costs in connection with the OBOs of 68% of 1,423 issuers who declined to pay for delivery to OBOs in 2010.

213 In cases where the investors subscribe to Broadridge's ProxyEdge® product, they will receive the proxy materials electronically regardless.

214 While this is a real problem in the United States, the fact that quorum levels in Canada are quite low makes this unlikely here. Corporate law in Canada generally provides that a quorum is a majority, unless the by-laws of the issuer provide otherwise. It is common practice for issuers to reduce the risk of not making quorum by having their by-laws require a much lower percentage, often as low as two persons present in person or by proxy holding not less than 5% of the shares. However, low quorum requirements can feed the problem of a small number of knowledgeable shareholders setting the direction of the company, as the requirement for a vote to pass is commonly a majority of the votes present in person or by proxy. By way of contrast, NASDAQ listed companies must have a quorum of at least one-third. Some proxy advisory services are now recommending that quorum should not be less than two people holding at least 25% of issued and outstanding shares.

24.4.3 Policy Issues and Proposed CSA Amendments to Address the Failure of Some OBOs to Receive Their Materials

There has been a great deal of focus on the "disenfranchised OBOs" discussed in the previous section, particularly in connection with the Proposed Amendments to NI 54-101. The publicly available statistics make it difficult to assess the magnitude of the problem. Additional independent study is required in order to properly assess the issue. In our view, this should be done as part of the broader reconsideration of the OBO/NOBO distinction which we are raising for consideration in Section 40 of this paper.

The suggestion has been made by a number of parties that the costs of delivery to OBOs should be borne by the issuer, not by the investors or intermediaries. This approach is supported by the IIAC, by Broadridge and by the CCGG, for example. While it may make sense for issuers to pay for the delivery of materials to all, not just some of their investors, that is not the policy decision made by the CSA when NI 54-101 was first enacted. When the first draft of NI 54-101 was sent out for comment in 1998[215], the draft legislation attached included the following provision:

> 3.8 Client to Bear Cost of Confidentiality - Except to the extent that a reporting issuer or other person or company is required under this Instrument to pay the costs, including postage, of sending securityholder materials, an intermediary that sends securityholder materials to an OBO in accordance with this Instrument is entitled to recover from the OBO the reasonable costs, including postage, incurred by the intermediary in sending the securityholder materials to the OBO.

That provision was eliminated by the time NI 54-101 was released in it final form in 2002. However, the mechanics that gave way to this approach were retained and remain in place today. The issuer is required to pay fees (plus the cost of mailing) to the intermediaries in respect of OBOs who have declined to receive the materials in question.[216] There is no requirement for the issuer to pay such fees and costs to the intermediaries in respect of OBOs who have requested the materials. The effect is therefore that the OBO is required to pay such fees and costs. When an intermediary receives proxy materials from the issuer, it is required to deliver them to the OBOs (and to the NOBOs if the issuer has requested that it do so).[217] There is no exception for situations in which the intermediary cannot or chooses not to charge its OBO client for the fees and costs in question.

The problem is that this represents a change in a long standing regulation that would impose additional costs primarily on smaller issuers. Statistics maintained by Broadridge show that larger issuers typically absorb the costs without being required to do so. Many smaller issuers do not elect to do so as a means of containing expenses. It may be a difficult argument to make to many smaller issuers that these costs should be transferred from the OBOs to them.

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215 *Notice of Proposed National Instrument* 54-101, O.S.C. (1998) 21 O.S.C.B. 1388.

216 NI 54-101, s. 2.14.

217 NI 54-101, s 4.2.

The CSA has to date not accepted the argument that issuers should bear the additional costs involved in paying for delivery to OBOs who have indicated that they wish to receive their materials. Proposed Amendments to NI 54-101 use disclosure to deal with the issue of non-delivery of materials to OBOs who wish to receive their materials. If an issuer is not paying for intermediaries to send proxy-related materials to its OBO investors, it must disclose that fact in its proxy materials and advise OBOs that it is their responsibility to contact their intermediary to make any necessary arrangements to exercise their voting rights.[218] This is, of course, circular. If the OBO is not receiving its materials, it will not have the benefit of the disclosure about why it is not receiving its materials. The OBO could get the information online. Assuming that the OBO is aware that it should be doing this, the OBO would have to invest the time to track the timing of the annual meeting and know when the materials would be available on SEDAR.

24.5 Deciding Which OBOs and NOBOs Will Receive Proxy Materials

When a non-registered investor opens an account with an intermediary, it also advises that intermediary which proxy materials the investor wishes to receive. The non-registered investor selects from one of three options:

- all, meaning the investor will receive proxy materials for all meetings;
- special, meaning the investor will receive materials only for special meetings; or
- decline, meaning the investor does not wish to receive any materials whatsoever.

This choice is offered for the investor's benefit. There are many investors who know that they will not vote and prefer to avoid finding in their mail packages of proxy materials that they will not read. In electing to receive only some or none of the materials, the investor is, however, only giving the issuer the option not to deliver those materials to them. It is always open to the issuer to send proxy materials, offering documents and other investor materials to any of its non-registered investors.

How does an issuer decide which non-registered investors will receive its materials? Typically, issuers send materials only to investors who have indicated that they wish to receive them. This may be a cost-saving measure or a reluctance to annoy their investors with unwanted materials. However, it is open to issuers to take the view that they want all investors to receive the materials, whether or not an investor thought this was important at the time they opened their account with their broker. The non-registered investor's decisions about which materials to receive is based on all of the securities held for it through that intermediary in a given account. In some cases, the issuer may perceive an advantage in engaging either with the smallest possible number of its investors or casting the net as broadly as possible.

A dissident may make a different choice about the universe of investors to which it will mail. In many cases, if a dissident selects a different universe for its mailings, the issuer will follow up with an additional mailing to investors not on its original list. An additional level of complexity in tabulating votes is introduced if the issuer uses Broadridge to do its NOBO mailings, but the dissident elects to do the NOBO mailing itself.

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218 Proposed Amendments to NI-101, s. 9.2(a).

24.6 Timing of Delivery

24.6.1 Requirements

Securities regulations establish time frames intended to put printed copies of shareholder materials into the mail 21 days before the date of the meeting.[219]

Materials to be sent indirectly by the proximate intermediary (typically through Broadridge) by first-class mail must be delivered to Broadridge by the issuer three days prior to the 21st day before the meeting date, and four days if delivery is by other than first-class mail. Under the securities regulatory regime, if one intermediary receives meetings materials from another intermediary, it is required to send those materials on to its investor clients within one business day of receipt. However, this provision is redundant since Broadridge does the mailing directly to virtually all of the intermediaries.

24.6.2 Issues

In researching this paper, we heard a great deal of anecdotal evidence of materials being delivered late – in some cases after the date of the actual meeting – thereby disenfranchising the investor in question. There could, of course, be any number of explanations for such delay. This highlights the fact that there is no way to audit the system from beginning to end and so no means of pinpointing where a problem may be occurring.

24.6.3 Proposed Amendments

The Proposed Amendments to NI 54-101 would remove the reference to first-class mail and require printed materials to be delivered to Broadridge at least three business days before the 21st day before the meeting date in all cases.[220]

The proposed requirements with respect to notice-and-access are less prescriptive. The issuer must provide the notice to the intermediary "in sufficient time" for the intermediary to send it to the investor at least 30 days before the meeting date.[221] If the issuer is using notice-and-access (discussed below) for some of its investors and paper delivery for others, the paper copies must be sent on the same day as the notice.[222]

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219 NI 54-101, s. 2.9.

220 Proposed Amendments to NI 54-101, s. 8.

221 Proposed Amendments to NI 54-101, s. 8.

222 Proposed Amendments to NI 54-101, s. 8.

24.6.4 Recommendation

Given the importance of investors receiving their materials on a timely basis, we raise for consideration the suggestion that mailing the materials in a timely fashion should be an enforceable obligation under Canadian securities laws and that anyone who is responsible for mailing (primarily the transfer agents and Broadridge) should be required to file certificates stating the date on which they mailed materials to non-registered investors. They cannot, of course, be responsible for when the materials are delivered, because responsibility typically lies with Canada Post.

The advantages of developing a system-wide audit which could, among other things, test compliance with mailing requirements, is discussed elsewhere in this paper.

25 How Materials Are Delivered

25.1 Printed Materials

The obligation of the issuer to send proxy materials to registered shareholders is quite straightforward. The issuer sends to the registered holder both the proxy materials and the form of proxy. Taking into account the requirements of corporate and securities law, as well as those of the stock exchange, those materials must be delivered between 21 and 60 days before the meeting date.[223] Producing printed proxy materials is expensive; the cost per package ranging anywhere from $8 to $12 per shareholder. Issuers therefore need to know how many investors they have, how many have asked to receive materials and how many have opted to receive the materials electronically.

The time it takes to produce printed materials obviously varies, but the timetable for doing so must be set so that adequate time is available for the printer to typeset the document, for the issuer and its advisors to review it and for commercial copies to be printed and delivered to the proximate intermediaries.

The timetable is therefore set by working backward from the above mailing requirement deadlines. The commercial printing of the materials is usually scheduled to take place one to three business days before the first required delivery of materials (that is, the delivery of materials to the proximate intermediaries). The final deadline for comments to the printer on the typeset proofs of the materials is usually the business day before commercial printing, and the materials are usually sent to the printers for typesetting three or four days in advance of this deadline.

For example, the materials may be sent to the printer on a Friday to be typeset over the weekend. The typeset proofs would be returned by the printer first thing Monday morning and comments on the typeset proofs would be sent to the printer and turned during business hours on Monday. Commercial printing would take place on Tuesday and the printer would deliver the appropriate quantities of the materials to the proximate intermediaries on Wednesday. The timeline for printing does not have to be this compressed (and could actually be more compressed, e.g. with

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223 *Supra* note 201.

the cooperation of the printer and the incurrence of additional costs by rush printing the materials overnight instead of during the business day).

25.2 Electronic Delivery

25.2.1 How It Works

Where electronic delivery is available, the issuer will arrange to host the material in electronic form on its website (or on a website maintained by the transfer agent). When the mailing of material is complete, registered shareholders and NOBO investors requesting electronic delivery will receive an e-mail with a message in it, as well as links to the material and the voting site.

The same process applies for OBOs, except that Broadridge makes the proxy materials available on a website, which it maintains for both OBOs and for any NOBOs to which it has mailed.

If the transfer agent or Broadridge sends an e-mail message and receives notification that it was undeliverable, the investor will be sent a hard copy package and, in most cases, a letter advising them that its e-mail address on record was not useable, and encouraging them to re-enrol.

25.2.2 Conditions to Electronic Delivery

An investor is entitled to a paper copy of any materials that the issuer is required to provide to it. In 1999, the CSA adopted a policy[224] to provide guidance to market participants (including issuers and intermediaries) about when electronic delivery will be an acceptable substitute for paper delivery.[225] In the view of the CSA, four conditions must be met:

- the recipient must receive notice that the document has been or will be sent, or will be made available, electronically;
- the recipient must have easy access to the document;
- the sender must have evidence that the document has been delivered or made available; and
- the document that the recipient receives must not be different from the document delivered or made available by the sender.[226]

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224 These matters are dealt with in *Delivery of Documents by Electronic Means*, O.S.C. NP 11-201, (1998) 21 O.S.C.B. 7782.

225 This is the case unless the issuer's articles and bylaws prohibit electronic delivery, which is not common.

226 NP 11-201, s. 2.1(2).

These conditions may be deemed to have been satisfied if the sender obtains the "informed consent" of the proposed recipient.[227] The contents of the consent recommended by the regulators includes a list of the types of documents that would be delivered electronically, a "detailed" explanation of the electronic delivery process and specification of software and technical requirements for viewing and retrieving documents.

25.2.3 How Consent is Obtained

Although there is no specific requirement for an issuer to obtain an investor's consent to electronic delivery, in practice, consent is typically obtained to avoid any suggestion that delivery was not effective.[228]

Intermediaries are required to ask clients whether they consent to electronic delivery at the time the client account is opened. [229] However, neither the issuer nor the transfer agent may rely on a consent given to the intermediary. The issuer must therefore embark on a separate path to obtain consent to electronic delivery. If the issuer wishes to mail directly to NOBOs, it must obtain a NOBO list from Broadridge and solicit consents from the NOBOs.[230] Then, each time there is a mailing, the issuer must cross-reference their current list of consents against the new NOBO list and either solicit further consents or provide paper copies to any new NOBOs (including to those NOBOs who have advised their intermediary that they prefer electronic delivery). This process is so awkward and unreliable that few, if any, issuers[231] take this step, with the result that very few NOBOs who receive their materials directly from the issuer (through the transfer agent) have the opportunity to receive their materials electronically.

There is a similar process for registered shareholders. The issuer mails a consent form to the registered holder (either as a standalone mailing or as an additional enclosure in another required mailing, such as a dividend mailing, interim report mailing or proxy mailing). The consent form would be returned to the transfer agent who would code the respective accounts. When the next mailing occurs, the transfer agent would use these codes to determine who gets a hard copy of the documents and who gets the documents electronically.

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227 Informed consent allows the inference that the deliverer and recipient have agreed as to the means of delivery and that, in so agreeing, the recipient is implying that it has the necessary technical ability and resources to access the document and that the recipient will actually receive the document. However, the form of consent cannot effectively waive what the regulators view to be fundamental aspects of the access components of delivery, and if a consent were to have that effect, the regulators could take the view that delivery had not been effected.

228 If the deliverer effects electronic delivery without having obtained a consent, the deliverer bears a substantially more difficult evidentiary burden to prove that the elements that comprise effective electronic delivery have been satisfied.

229 Intermediaries are required under NI 54-101, s. 3.2 to obtain a client's consent to electronic delivery of documents.

230 Because this NOBO list is not being requested in connection with a mailing, it will not show the intermediary through which a NOBO holds its interest, making it very difficult to reconcile this list to the NOBO list obtained in connection with a mailing.

231 ACE Aviation Holdings Inc., Report of voting results (NI 51-102 s. 11.3) (5 July 2010), online: <http://www.sedar.com>. To date, the board of ACE Aviation has made no comment about the results.

We understand that the response rate when transfer agents send electronic delivery consents to their registered shareholders is very low. The consents are seldom standalone mailings and it may be that they are simply overlooked by many investors. In addition, the form of request mandated by the securities regulators is far from user-friendly[232] and may well discourage investors from sending completed forms back.

25.2.4 Regulatory Overlap

The issue of consent is further complicated by the overlapping provisions of NI 51-102, NI 54-101 and NP 11-201. Consent to electronic delivery of proxy materials is given by the investor to its intermediary when opening an account. That consent applies to the account and not the individual holdings in that account, whereas the consent for financial statements and Management Discussion and Analysis ("MD&A") is requested by the issuer annually in respect of a particular security. Under NI 51-102, a beneficial holder who has indicated that it wishes to receive all materials is required to give an annual consent to electronic delivery of financial statements and this consent can, in certain circumstances, override a consent given under NI 54-101 regarding the delivery of proxy materials, where the financial statements are delivered together with proxy materials. At best, the system is confusing to the average investor, who may not clearly distinguish between the various consents it is required to give or understand that one consent may override another. Further, the timing of obtaining the consent, the timing of delivery of the financial statements, and the scope of the consent are not adequately integrated.

26 Transition to Notice-and-Access

26.1 General

With the number of delivery options currently available – paper, electronic, notice-and-access – the CSA is proposing to amend the current requirements to provide flexibility to the issuer. For meetings other than special meetings, the issuer may opt for paper-based delivery or for notice-and-access. Alternatively, with the consent of the investor, it may deliver materials electronically or by any other method.[233] This flexibility also applies to materials other than proxy-related materials.[234]

26.2 The U.S. Experience

In the United States, the SEC amended its rules in 2007 to expressly permit a notice-and-access system for proxy materials. The notice-and-access process provides an issuer soliciting proxies with an alternative delivery method whereby the issuer posts the proxy materials on an Internet website (the "access") and advises the investors of the presence and location of the proxy

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232 The prescribed explanatory text to a client electing to be an OBO or a NOBO includes a description of the electronic delivery of documents, but the prescribed response form does not include a consent (or refusal) to receive documents electronically. Rather, it specifies that the client should indicate on a separate form whether it is prepared to receive materials electronically. See NI 54-101F1 at "Electronic Delivery of Documents".

233 Proposed Amendments to NI 54-101, s. 4; repealing and replacing s. 2.7.

234 Proposed Amendments of NI 54-101, s. 5; repealing and replacing s. 2.8.

materials and how to access them (the "notice"). Prior to the amendment of the rules, issuers wishing to effect electronic delivery of proxy materials had relied on a series of interpretive views issued by the SEC that effectively supported the SEC view that use of efficient technology should be encouraged and that any information that could be delivered in paper format could equally be delivered electronically.[235] However, issuers were expected to continue to make paper delivery available until electronic delivery becomes "more universally accepted". The SEC also took views that established requirements for evidence of delivery and consent to electronic delivery not dissimilar to those still in effect in Canada under NP 11-201.

The U.S. notice-and-access model requires an issuer to post its proxy materials on an Internet website at, or prior to, the time investors are notified that the materials are available and the materials must remain posted through the conclusion of the shareholder meeting. Once an issuer has posted its proxy materials, it begins the solicitation process by sending to investors, at least 40 calendar days before the date of the shareholder meeting, a "Notice of Internet Availability" informing investors that the issuer's proxy materials are available online. It is not clear why this notice must be given so far in advance of the meeting – the same time period under Canadian law, for example, would be well in excess of the minimum number of days to mail materials. Under the revised SEC rules, notice-and-access can be effected without the need for consent or establishing evidence of delivery. This creates an opt-out model as the issuer is still required to make paper copies of the proxy materials available if the shareholder requests them; however, the notice must still be mailed. A person soliciting proxies, other than the issuer, can elect to run an "electronic only" solicitation. This reflects that same reluctance as we are experiencing in Canada to move away from the paper-based system entirely, even though there is an increasingly small percentage of (mostly retail) investors who actually rely on paper in order to cast their vote.

The SEC viewed the 2007 rule amendments as providing to issuers a reliable and cost-efficient means of delivering proxy materials to investors and also providing to persons soliciting proxies, other than management, a means to reduce the costs of engaging in a proxy battle. The new rules represented a significant attempt at modernization of the proxy delivery process by the SEC. The effects of the rule changes were, however, unexpected. Statistics provided by Broadridge indicate that issuers had saved over $260 million in printing costs for the period from rule implementation up to early 2009, but that retail voting response rates for issuers adopting notice-and-access fell by 73 percent.[236] Many institutional investors were already effectively voting electronically through

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235 One obstacle was an NYSE that required delivery of paper annual reports, including financial statements, that accompany proxy materials.

236 See SEC Concept Release, *supra* note 31 at 88-89. The SEC states that they find it difficult to conclude that the "notice-and-access" model has contributed to a decline in retail investor participation. The SEC notes:

> To be sure, the number of retail accounts submitting voting instructions when issuers use the notice-only option is lower than the number of retail accounts submitting voting instructions, when issuers use the full-set delivery option. The number of retail shares being voted, however, does not appear to differ substantially. More importantly, because issuers can elect whether to use the notice-only model, it is difficult to discern whether patterns in voting behaviour are due to notice-and-access or to other factors. Issuers who choose the notice-only model may differ from other issuers in ways that may also correlate with voter participation, such as size or other characteristics. Some issuers have chosen a hybrid model, continuing to distribute full package of proxy solicitation materials to selected shareholders based on the size of their holdings or their

the use of their own proprietary voting platforms or Broadridge's ProxyEdge®, an online proxy portfolio management system. ProxyEdge® is a suite of electronic voting services that help institutional investors simplify the management of institutional proxies by providing meeting notifications, voting, tracking, mailing, reporting, record maintenance and assistance with SEC vote disclosure rules. It is subscribed to by the institutional investor either directly from Broadridge or used by the institutional investor via a proxy advisory service that has white-labelled the product from Broadridge. Broadridge also provides the proxyvote.com website for Internet voting by retail investors.

There has been much discussion in the United States about why the notice-and-access rules, though intended as a cost savings to issuers (and others soliciting proxies) and as a convenience to investors, have resulted in such low voter response. Theories include speculation that the strict contents mandated for the notice, such as listing the matters to be voted on at the meeting in the same order as they appear on a form of proxy and the mandating by the SEC of language for the notice that is meant to highlight for investors the online availability of materials, actually confused rather than clarified the process for investors, who mistook the notice for a proxy form. Other investors mistook the notice for junk mail.

The SEC reviewed its rules with a view to amending them to ensure that the legislation facilitates rather than hinders investor participation. The effective date of the amendments was March 29, 2010. The amendments reduce the strict notice content requirements and allow issuers to provide explanatory materials on the notice-and-access process to investors. The amendments are viewed as a positive step by the SEC, but, as with most process changes, there is a learning curve and behaviour change curve that could result in increased participation with the passage of time and sufficient investor education. The SEC recognizes that investor education is a key component of adoption and is developing a program to educate and inform investors about the notice-and-access process.

The U.S. notice-and-access regime does not allow an issuer to send a proxy card or voting instruction form concurrently with the notice. The only exceptions are that the issuer may send a pre-addressed, postage-paid reply card so investors can request paper or e-mail copies of the proxy materials and, as of March 2010, an explanation of the e-proxy voting method and why the issuer is using that method.

The prohibition of concurrent delivery reflects a belief by the SEC that "it is important for the notice to be furnished in a way that brings it to the shareholder's attention," and sending the notice concurrently with the proxy card or voting instruction form might cause investors to disregard the materials altogether.[237] This could result, in other words, in investors simply marking their ballots in favour of the management recommendations, without the benefit of having read the materials. The recent amendments to notice-and-access allow issuers more leeway to develop their own writing in the notice, including the ability to inform investors that the notice is not a form of proxy. But concurrent mailing of the notice and a proxy card or voting

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voting histories suggesting that these issuers may believe that full-set delivery affects voter participation in some cases.

237 U.S. Securities and Exchange Commission, Release No. 34-55146, "Internet Availability of Proxy Materials" (22 January 2007) at 14, online: <http://www.sec.gov/rules/final/2007/34-55146.pdf>.

instruction form is still forbidden, suggesting relatively little confidence in U.S. investors to follow the instructions on the form. As discussed below, Canadian securities regulators have taken an opposite approach.

26.3 Proposed Notice-and-Access Regime in Canada

The CSA have proposed a notice-and-access regime in Canada,[238] with the objective of promoting the use of the Internet as a potentially reliable and cost-efficient means to shareholder communication. The proposals would not apply to special meetings – effectively confining the use of notice-and-access to annual meetings at which shareholders will not also be asked to vote on fundamental changes or other matters that require two-thirds of the votes cast for approval.[239] This approach would make it impossible for many TSX Venture issuers to use notice-and-access, since options and similar plans must be approved as special business under the TSX Venture rules.

The CSA proposals are broadly similar to the U.S. notice-and-access system. Issuers would post their information circulars on the Internet[240] and then send a notice to investors advising that the circular had been posted and explaining how to access it. The notice would be accompanied by the relevant voting instruction form.[241] At the request of an investor, the issuer would be required to send a paper copy of the information circular to the investor at the issuer's expense.[242]

Two other important distinctions between the U.S. and Canadian systems would be maintained in the Canadian notice-and-access system. First, issuers could continue to send proxy-related material directly to, and solicit voting instructions directly from, NOBOs. Second, issuers will continue to have the option not to pay for intermediaries to forward proxy-related materials to OBOs; although if an OBO is sent notice of the availability of proxy materials by an intermediary, the OBO can request paper copies of those materials from the issuer at the issuer's expense.

If issuers choose to use notice-and-access for only some of their investors, they will be required to disclose in their proxy materials an explanation of that decision[243] (unless the issuer had not made that decision at the time the proxy materials were being prepared).[244]

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238 Proposed Amendments to NI 54-101 at 3955.

239 The CSA has stated that it would like to monitor the implementation of notice-and-access before it is permitted for special meetings at which fundamental changes are being considered.

240 On a website other than SEDAR – most likely the issuer's own, its transfer agent's, or Broadridge's, website.

241 This is different from the U.S. system, where Rule 14a-6 of the *Exchange Act* explicitly prohibits the soliciting party from including a proxy card or VIF with the Notice of Internet Availability.

242 This is different from the U.S. system, in which the intermediary is required to send the paper copy to the investor at the intermediary's expense.

243 Proposed Amendments to NI 54-101, s. 9(2).

244 Proposed Amendments to NI 54-101, s. 9(3).

PART VI – HOW VOTES ARE CAST AND COUNTED

Providing proxy materials to registered shareholders and non-registered investors is the first step in the voting process. The next step is, of course, to collect proxies from registered shareholders and voting instructions from non-registered investors and then to translate those instructions into votes that are cast at the shareholder meeting.

27 How the Investors Vote

27.1 Proxies

The purpose of a proxy is to transfer the right to vote a security at a specified shareholder meeting of the issuer from one person to another. In the first instance, the right to vote the security belongs to the registered holder of that security. Most commonly, a shareholder signs a proxy to the Management Appointees to represent the shareholder at the meeting when they cannot attend. Where CDS is the registered shareholder, securities regulation requires CDS to appoint that right to vote to the CDS participants in proportion to the position they hold in that security at record date. Rather than providing proxies down through the rest of the system until the investor ultimately has a proxy in hand, the intermediaries request instructions on how to vote and then cast the votes on behalf of their investor clients in accordance with those instructions.

Proxies must be delivered to the issuer in accordance with their terms, which typically include a voting cut-off time for delivery of proxies.

The term "omnibus proxy" is part of the proxy voting jargon. It is intended to communicate that it represents an entire position held by an intermediary and delegates the vote to some or all of the intermediaries or clients holding through that intermediary, rather than being just a proxy with respect to a single investor's interest.

27.2 Form of Proxy

The issuer provides a form of proxy only to its registered shareholders. The form of the proxy has been regulated since the 1960s, originally to curtail management practices that were designed to influence shareholders to vote in favour of management's proposals. Non-registered investors must send a request for voting instructions (referred to as a "VIF") which is discussed in more detail below.

27.2.1 CDS's Omnibus Proxy

Shortly after the record date, CDS sends an omnibus proxy to the issuer, showing that CDS (as the registered shareholder) has given its proxy to each of the CDS participants for the number of shares shown for each participant on the CDS list. CDS confirms to each of the participants that it has delivered the omnibus proxy to the issuer.[245] CDS's role in the process is then over.

27.2.2 NOBO Omnibus Proxy

If the issuer takes responsibility for mailing to its NOBOs[246] (typically through its transfer agent), it will request from each of the intermediaries, or their agent, an omnibus proxy to cover the total number of shares held by their NOBO clients.[247] The intermediary delivers to the issuer an omnibus proxy authorizing the management nominees listed on the management form of proxy to vote a proxy on behalf of all NOBOs that submit instructions. The issuer (or its transfer agent) then sends a request for voting instructions to each of the NOBOs (discussed below).[248] Very often this takes the form of a VIF. In some cases, the issuer (or the transfer agent on its behalf) sends a proxy to its NOBOs.

27.2.3 Mini Omnibus Proxies

Mini omnibus proxies are provided by an intermediary who is a CDS participant (and who is therefore named as a proxy holder in the CDS omnibus proxy) to one of its clients who may also be an intermediary. For example, a participating broker may act as a clearing broker for correspondent brokers (non-CDS clearing brokers). In addition, mini omnibus proxies may be provided by intermediaries further down the proxy chain from a depository or with respect to shares held in a registered position by an intermediary.

27.2.4 DTC Proxies

An exhaustive examination of the issues relating to securities held outside of Canada is beyond the scope of this paper. However, it is important to refer at least to DTC, the U.S. counterpart to CDS, because of the number of U.S. investors in Canadian issuers. DTC, of course, does not fall under the jurisdiction of the CSA and so follows its own practices in respect of the proxy voting process.

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245 NI 54-101, s. 5.4. CDS must deliver the omnibus proxy within two business days after the beneficial owner determination date (which is the same as the voting record date).

246 NI 54-101, s. 2.9. The issuer will have advised the intermediaries that it intends to do the NOBO mailing when the transfer agent sends to the intermediaries the Request for Beneficial Ownership. NI 54-101, s. 2.9.

247 This request is part of the Request for Beneficial Ownership, NI 54-101.

248 NI 54-101, s. 4.1(b).

One aspect of the DTC practice that differs from the Canadian practice is that it will only provide its omnibus proxy directly to the issuer on request of the issuer. This is in contrast to CDS, which is required to send the omnibus proxy to the transfer agent under securities laws. The transfer agent (in its capacity as official tabulator) needs this omnibus proxy in order to be able to reconcile an intermediary's position with its entire position. Without the DTC omnibus proxy, it may appear that an intermediary is over-voting its position held through CDS.

Of course, most issuers know that they have investors with positions held through DTC and the transfer agent will prompt the issuer to provide the DTC proxy to it. The problem is that until the transfer agent has the DTC omnibus proxy, it is not in a position to reconcile all of the votes received. If the DTC omnibus proxy arrives too late in the process, there may not be time to sort out all of the issues, potentially leaving many votes untabulated.

27.3 How Do Non-Registered Investors Communicate Their Voting Instructions?

27.3.1 What is Required by Securities Regulation

Securities regulation provides the mechanism for non-registered investors to provide instructions as to how their position is to be voted. When an issuer (through its transfer agent) or the intermediary (in practice through Broadridge) sends proxy materials to non-registered investors, it also sends a request for voting instructions. That request must include certain disclosure required by securities regulation.[249] Securities regulation also provides a form that can be used, but it does not at present require that form to be used, as long as the form or document that is used requests or includes the same information as set out in the form provided in the regulation.[250]

27.3.2 How Are Instructions Requested in Practice

In practice, the form of the material that the investor receives requesting its voting instructions depends on whether Broadridge (on behalf of the intermediaries) or the transfer agent (on behalf of the issuer) is responsible for the mailing.

If the mailing is done by Broadridge (which will be the case for almost all OBOs and some NOBOs) then the investors will receive with their proxy materials a VIF designed by Broadridge to feed into its system. Broadridge uses the issuer's form of proxy to create its VIF and then asks the issuer to sign off on the VIF to ensure accuracy.

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249 The request for voting instructions (a defined term in NI 54-101) must be in the form of "Request for Voting Instructions Made by Reporting Issuer", NI 54-101F6 in the case of a request sent by the issuer, or in the form of "Request for Voting Instructions Made by Intermediary", NI 54-101F7 in the case of a request sent by an intermediary.

250 NI 54-101F7, s. 1.3 provides that the issuer or the intermediary (as applicable) may substitute another form or document or combine the required form or document, so long as the form or document used requests or includes the same information contemplated by the required form.

If the mailing is done by the issuer through its transfer agent, then the form provided depends on the issuer and the transfer agent. It is the issuer's responsibility to prepare the proxy materials, proxy and request for instructions.[251] The issuer simply retains the transfer agent for certain functions, including sending the requisite material to registered shareholders and NOBOs. Computershare prints the forms of proxy and VIFs on behalf of their issuer clients, but it is the issuers who determine the content.

Some issuers design their materials so that the form which NOBOs receive looks exactly the same as the form of proxy sent to the registered shareholders, with the additional disclosure necessary to comply with the content requirements of securities regulation set out in the circular. The transfer agent affixes a proxy label on the form of proxy that identifies the vote as being registered to a NOBO and also identifies the financial institution so that the transfer agent can reconcile the instructions to the position stated on the omnibus proxy held by that financial institution.

The Proposed Amendments to NI 54-101 would require everyone to use the form of VIF set out in the instrument. In other words, issuers would no longer have the flexibility to use a form which looks more like the form of proxy. It is not clear to us what benefit accrues from limiting the flexibility of the issuer in this way.

Broadridge provides an online proxy management service to institutional investors called ProxyEdge® which permits institutions and money managers to receive electronic notification and register their votes online with Broadridge.

27.4 How Investors Send Their Voting Instructions Back

Securities regulation and some corporate legislation[252] requires that investors provide their voting instructions in writing. However, under NP 11-201, the "in writing" requirement for voting instructions can be satisfied by electronic delivery of a document, including telephone delivery, so long as the electronic format ensures the integrity of the information in the document and enables the recipient to maintain a permanent record of the information. The vast majority of registered shareholders send their proxies in writing, as do the NOBOs who receive their materials from the transfer agents. Institutional investors (who also tend to be OBOs) are much more likely to vote electronically.

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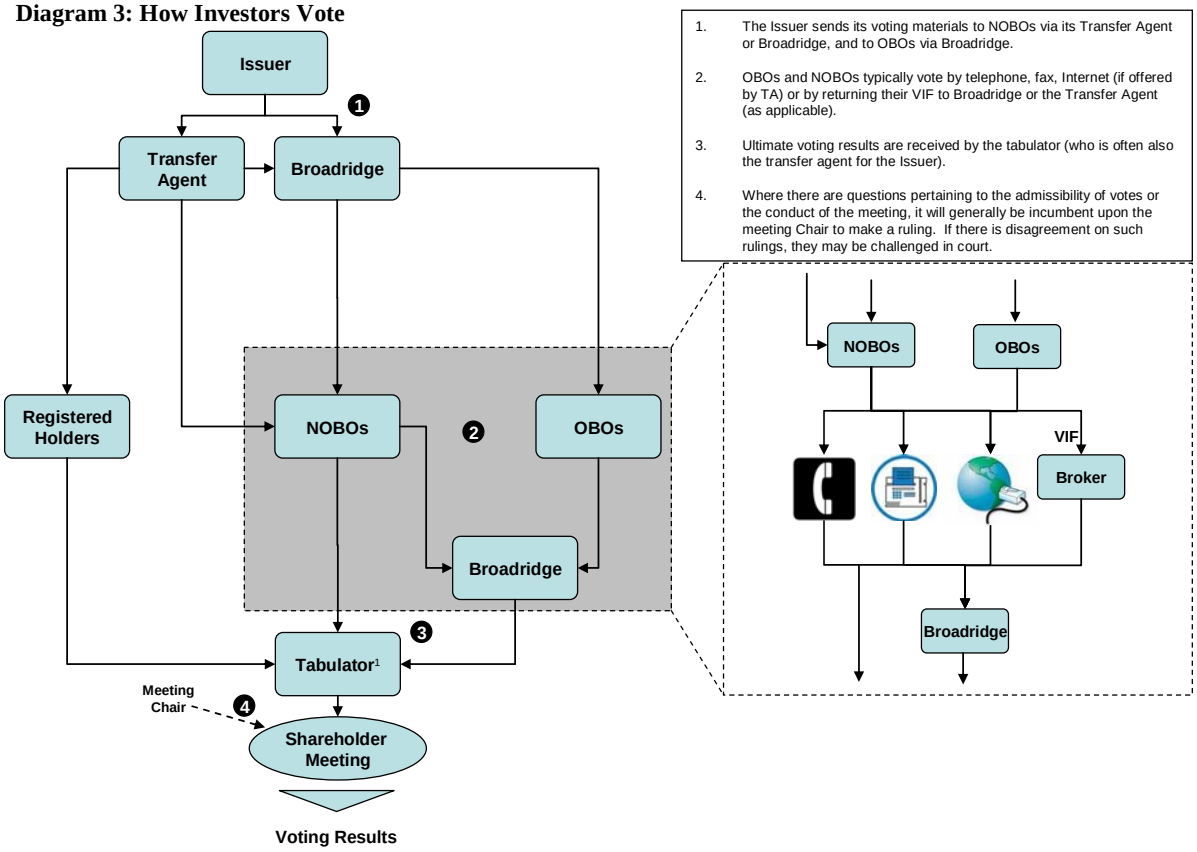
[251] Computershare requires the issuer to use the tabulator's form of proxy and VIF in order to facilitate scanning of the results.

[252] CBCA, s. 153.

Voting is controlled in electronic systems by providing to the investor a unique control number[253] on the voting instruction form or proxy card sent with the paper format proxy materials, or included in the email that provides notification of the availability of the proxy materials. When the investor votes by telephone or online, the control number identifies the shareholder to the electronic system maintained by the tabulator. For example, the website www.proxyvote.com, which is the online system operated by Broadridge, and websites operated by transfer agents allow the investor to register its votes on the meeting subject matter. The investor has the ability in most electronic systems to change any vote submitted using the electronic medium up until the time the tabulator closes the electronic system for voting. Broadridge continues to tabulate and deliver votes to the issuer's tabulator after the proxy cut-off date and up to the meeting date, should the issuer waive the proxy cut-off. Some transfer agents' systems are designed to stop tabulation of electronic votes at the time of the published voting cut-off, although it leaves the voting open in the event that the cut-off is waived. Any holder voting on the Internet after cut-off receives a message that the vote was received after cut-off.

Diagram 3: How Investors Vote



1. The Tabulator is typically the transfer agent for the issuer.

253 There is no uniformity in how the unique control numbers are generated; each transfer agent or service provider has its own methodology.

Each electronic system is proprietary to the transfer agent or Broadridge who supplies the service. Electronic systems in theory provide easy and immediate access to investors and are cost-effective to the issuer since they reduce the human processing cost and eliminate the cost of return postage. They can also reduce human error on the tabulator side. The limitations in these types of online voting systems revolve around the currency of technology. Most of the systems are optimized to display using Microsoft's Internet Explorer browser, or may require JavaScript or Adobe plug-ins and therefore are geared to the PC world (although Broadridge supports the Safari and Firefox browsers for Mac users). As a result, display and accessibility can be limited for Mac users on some online voting systems.

In some cases, brokers may accept voting instructions from their clients over the phone, then provide email instructions internally to their proxy department, which are passed on to Broadridge.[254] This would of course present an audit issue in any end-to-end audit arrangement.

The Proposed Amendments to NI 54-101 provide that issuers must maintain a record of each request for voting instructions sent to a NOBO and the date and time of any voting instructions, including proxy appointment instructions, submitted to the reporting issuer.[255] It would also require intermediaries to do the same for all OBOs and NOBOs to which it delivers a request for voting instructions.[256] This is a positive step towards creating an auditable system. We agree that the Instrument should be amended in this way.

27.5 Use of Proxy Advisory Firms

Proxy advisory firms provide a variety of services, among them, analysis of meeting circulars and recommendations on how investors should vote their share. In addition, proxy advisory firms offer a number of back office functions to assist investors (typically institutional investors) in making sure that they are in a position to vote all of the shares they hold at each meeting at which it is entitled to vote. Finally, proxy advisory firms offer "voting platforms" that investors can use to cast their vote.

Proxy advisory firms provide recommendations to their clients about how to vote in connection with each meeting. Their clients may have their own proxy voting guidelines that determine how they will vote in most cases. They will typically provide those guidelines to the proxy advisory firm and instruct the firm to vote the investors in accordance with those guidelines In many cases, the investor will make discrete decisions with respect to each of the matters that comes before the meeting.

In many cases, however, the clients of the proxy advisory firms will instruct that their votes be cast in accordance with the proxy advisory firm's recommendations.

254 As related to us by the IIAC.

255 Proposed Amendments to NI 54-101, s. 10; repealing and replacing s. 2.17.

256 Proposed Amendments to NI 54-101, s. 17; repealing and replacing s. 4.5.

27.6 When the Beneficial Holder Wishes to Vote at the Meeting

27.6.1 Becoming a Registered Shareholder

If an investor wishes to attend a meeting of shareholders and cast a vote at that meeting, the simple solution might seem to be for that investor to become the registered holder. However, the process of moving shares into the name of the investor can often take two weeks, although it can be done more quickly.[257] The investor makes a request through its intermediary, who must then withdraw shares equal to the investor's position from its aggregate position in CDS. The investor also pays fees to its intermediary for this service. The transfer agent may also charge a fee if a rush delivery is required or where (particularly in the case of small issuers) the issuer does not absorb the certificate fee. Of course, if the securities are issued as BEO securities, becoming a registered holder is simply not an available option.[258]

Securities regulation provides an alternative to this protracted and often expensive process. The investor may either request a legal proxy (referred to as a "voting power of attorney") or write his or her own name on the VIF and return it to its intermediary. In that case, the intermediary passes this information on to the tabulator in advance of the proxy cut-off. Each of these options, as well as one other option, is discussed below.

27.6.2 Requesting a Legal Proxy

Securities regulation requires issuers and intermediaries to provide a legal proxy to an investor who requests one.[259] Issuers and intermediaries are required to include on the request for voting instructions that they send to non-registered investors, an option to receive a form of legal proxy.[260]

There are a number of problems with the legal proxy option. For example, when investors look at the VIF, many do not understand that they must either provide voting instructions to the intermediary (so the intermediary can vote on its behalf) or request a legal proxy (so the investor can vote directly – or name someone else to do so). If an investor fills out both parts of the VIF, they have provided conflicting instructions. Broadridge or the transfer agent will typically honour the request for a legal proxy.

Another issue is the amount of paper traffic that is required for this system to operate. First, the transfer agent or Broadridge mails the proxy materials to the NOBO. Next, the NOBO sends back to the transfer agent or Broadridge the VIF requesting a legal proxy. Then, the transfer agent or Broadridge sends the NOBO the legal proxy. Finally, the NOBO signs and sends the legal proxy to the transfer agent. This must all be completed before the cut-off date and there is often not enough time to complete each of these steps.

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257 Among other things, this will require the payment of an additional fee.

258 See Section 9.3 above.

259 NI 54-101, s. 2.18 and 4.5 impose these obligations on issuers and intermediaries respectively. The form of legal proxy is set out in "Legal Proxy", NI 54-101F8.

260 *Ibid*.

27.6.3 Appointee System

Under the "appointee system", an investor wishing to attend the meeting inserts its own name (or that of its appointee) on the VIF and returns the VIF to the intermediary. The intermediary then provides a cumulative proxy to the tabulator or scrutineer, which shows the names of the investors who had inserted their own name (or the name of an appointee), the position held and any voting instructions shown on the VIF. This system was in place under NP 41 (the predecessor to NI 54-101). Some investors mistakenly try to use a version of this system by writing in their own name and bringing the VIF to the meeting. The step that the investor will have missed is returning the VIF to the intermediary (who is the actual proxy holder) so that the intermediary can send it to the tabulator prior to the proxy cut-off date. When the investor arrives at the meeting with the completed VIF, it will be too late to deposit it. [261]

27.6.4 Broadridge Exemption

In February 2010, Broadridge obtained an exemption[262] from the requirement to send a legal proxy to investors under NI 54-101 provided that it implements the appointee system described above. This mirrors the amendments being proposed by the CSA in the Proposed Amendments to NI 54-101. The exemption expires on December 31, 2010. If NI 54-101 has not been amended by that time to substitute the appointee system for the legal proxy system, it is expected that the exemption will be renewed.

27.6.5 Proposed Amendments

The Proposed Amendments to NI 54-101 would eliminate the current requirement in respect of legal proxies, which requires investors to request a legal proxy (i.e. a second piece of paper) after they have received the VIF. Instead, when the investor indicates on the VIF (or on any other documentation acceptable to the issuer or the intermediary, as the case may be) that it wishes to be appointed (or have its nominee appointed) as a proxy holder, the issuer or intermediary must deposit the proxy within the required time period.[263] The investor will then be able to attend the meeting and vote in person.

27.6.6 Alternatives

One might ask whether it would not be simpler to provide proxies all the way down the chain (as was the case in Canada under NP 41). In fact, the STAC Protocol contemplates an issuer using this approach when it does its NOBO mailing through its transfer agents. STAC refers to this as an "Omnibus Legal Proxy", which is a proxy signed by the management nominee in favour of those investors on the NOBO list. This enables the transfer agent to send a form of proxy to the

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261 Where a proxy cut-off has been waived, it may be possible to still allow non-registered investors to provide voting instructions, but we understand that, in the case of OBOs, Broadridge must have been retained to attend the meeting.

262 *Re Broadridge Financial Solutions, Inc*. (19 February 2010), 33 OSCB 2119.

263 Proposed Amendments to NI 54-101, ss. 11 and 17. In addition s. 18 would introduce a complementary provision that would tie into this approach situations in which legislation requires a depository to appoint the proxy.

NOBOs instead of a request for voting instruction. It also allows the NOBO to either appoint the management nominee (or someone else) as its proxy and send the proxy back to the transfer agent or to simply take the proxy to the meeting and vote as if it was a registered shareholder. Very few issuers ever adopted the Omnibus Legal Proxy. This approach is not contemplated in NI 54-101 and so it is likely that issuers who might otherwise have used it did not do so out of concern that, without a specific reference to it in NI 54-101, it could be challenged.

Proposals to cascade proxy cards to individual investors have been criticized for "fragmenting" the process by introducing an alternative system that runs parallel to the existing request for voting instructions process.[264] In a 2010 report, the Securities Industry and Financial Markets Association ("SIFMA") pointed to three likely outcomes from establishing multiple side-by-side systems or fragmenting the number of actors who have responsibility for administering the system. First, it believes that it could undermine reliability and efficiency and result in higher costs for many issuers and their shareholders. Second, SIFMA believes that it would further erode retail shareholder participation, since investors would not be able to rely on their brokers as a single source of information and support. Finally, it points to "adverse implications for regulatory compliance as responsibilities are re-allocated among issuers and numerous additional parties, and for data security, leading to some "leakage" of clients' personal information as well as a firm's proprietary data".

It does not seem to us that these concerns would necessarily apply if the Omnibus Legal Proxy system were adopted in Canada, as it would not introduce any additional actors into the process and would streamline rather than complicate the documentation associated with NOBO voting.

28 Revocation

After an investor sends in a proxy or a VIF, that investor may subsequently wish to change that proxy or VIF to vote differently. If the investor is a registered shareholder, the process is quite straightforward. The registered shareholder may revoke a proxy by attending the meeting and voting in person, submitting a form of revocation, or simply by sending in another proxy.

The process is more complicated for non-registered investors. In the case of OBOs, and some NOBOs, both the revocation and the new VIF must be sent to and processed by Broadridge in order to take effect. If the issuer has done the mailing to NOBOs through its transfer agent, the revocation and new VIF must be processed by the transfer agent. In reality, most investors will call their broker if they wish to change their voting instructions.

One question that may arise is what action is appropriate if a NOBO appoints itself as proxy on the VIF and attends the meeting in person. Some transfer agents will allow the NOBO to vote at the meeting, if the transfer agent handled the NOBO mailing. Other transfer agents will refer the matter to the issuer for determination.

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264 Securities Industry and Financial Markets Association, "Report on the shareholder communications process with street name holders and the NOBO-mechanism" (10 June 2010), online: <http://www.sifma.org/regulatory/pdf/SIFMA%20White%20Paper_NOBO-OBO_June%2010%202010.pdf>.

29 Who Counts the Votes

There is a great deal of regulation around the proxy voting process up until the time the voting instructions are given to the intermediary. There are no rules for the tabulation of votes.

29.1 Tabulation of Proxies and Voting Instructions By Transfer Agents

The transfer agent is responsible for tabulating the proxies submitted by registered shareholders. It will do the same for voting instructions received from NOBOs if the transfer agent has done the NOBO mailing on behalf of the issuer. In most circumstances the transfer agent will act as the official tabulator and will also act as scrutineer for the meeting. As noted above, Broadridge also can be contracted both to provide the proxy materials to NOBOs, OBOs and registered holders, and to act as the tabulator for the meeting, although Broadridge does not have a significant share of this market.

29.2 Tabulation of Voting Instructions by Broadridge

Once an investor provides voting instructions to the intermediary (or Broadridge on its behalf), the intermediary is required to execute those instructions either directly or indirectly. In practice, voting instructions are delivered to Broadridge either by the non-registered investor or by the intermediary. Broadridge aggregates those instructions and then delivers the intermediary's total vote to the official tabulator electronically, using FTP and by fax.[265] These vote reports are sent to the final tabulator to reconcile and to be added to any other votes received already by the transfer agent with respect to that intermediary.

Physical VIFs that are mailed to Broadridge for tabulation are scanned through optical readers to record the vote. VIFs that cannot be read optically are processed manually and then double verified for accuracy. If a VIF cannot be processed because of some defect in the manner in which it was completed that Broadridge cannot resolve, Broadridge returns that VIF to the intermediary so that the intermediary may follow up with its client to resolve the issue. Votes are received by telephone and Internet through the 12 digit control number that is printed on the VIF. The control number is compared to a system database to verify that the control number is a record belonging to that specific mailing.

29.3 Official Tabulator

We are using the term "official tabulator" in this paper to describe the person who is responsible for collecting all of the votes from various sources and comparing them to the proxies that have been granted. The official tabulator is retained by the issuer. This service is most often provided by the transfer agent, but can also be offered by Broadridge.

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[265] However, in contested meetings, fax rather than FTP is used in order to support on demand reports.

Typically, the transfer agent is the official tabulator. Broadridge collects the voting instructions delivered to it from the clients of the intermediaries and delivers to the transfer agent regular vote updates through the use of a multiple proxy. Each multiple proxy represents all of the votes collected through an intermediary at the time of the update. It is important to note that Broadridge reports the aggregate vote received for each intermediary.

Intermediaries can also deliver votes directly to the official tabulator on paper, by mail or by fax, from Broadridge and other intermediaries.

The official tabulator must reconcile votes received against the omnibus and mini omnibus proxies issued to the intermediaries by CDS, DTC and other intermediaries and also to registered and nominee positions held directly or indirectly by the intermediaries.

There are no requirements governing the tabulation of votes or imposing any particular qualifications on the tabulator; it is, accordingly, simply part of the issuer's obligations in running a shareholder meeting. Since it is the issuer's responsibility, any discretion involved in that function is ultimately discretion to be exercised by the issuer. There is, however, a proxy protocol commonly used by tabulators to guide them in determining the validity of proxies and suggesting ways to handle over-voting.

The system in the United States is quite different. Many of the corporate statutes permit or require a corporation to appoint a person to inspect the results of a shareholder vote and report such results to the corporation. That person may be an officer or employee of the corporation, but particularly where there is a contested matter or a shareholder proposal is being considered, public companies will very often retain someone independent of the corporation to act as an inspector. In addition to enhancing the perception as to the fairness of the voting process, courts reviewing a contested vote will give greater evidentiary weight to the report of an independent inspector.

29.4 When Does Management Know How the Vote Is Going?

Broadridge has established a practice of providing a 15-day voting window, followed by daily vote reports that are sent to the official tabulator during the 10 days prior to the meeting. If the mailing was done less than 25 days before the meeting, the process will begin with a 10-day report and daily reports thereafter.

30 What Could Cause a Vote Not to Be Counted?

30.1 Proxy or Voting Instructions Have Not Been Delivered in Time

Under corporate law, an issuer is permitted to set a proxy cut-off time. If a proxy is deposited after the cut-off time, it can be rejected even if it is otherwise properly completed, unless the proxy cut-off is waived or extended by the issuer. Under many Canadian corporate statutes, the proxy cut-off must be no more than 48 hours (excluding Saturdays, Sundays and holidays) preceding the commencement of the meeting in respect of which the proxy relates.[266] Some issuers take advantage of the full 48-hour proxy cut-off; others provide for a 24-hour proxy cut-off.

Historically, the rationale for allowing a corporation to set a proxy cut-off time was to provide the issuer with sufficient time to count the proxies. Although technology has streamlined this part of the process, there remain a number of reasons for preserving this cut-off. Time is needed to run the voting list after the proxies are all tabulated, incorporate Broadridge vote reports into the final voting results, conduct final tabulation audits, and prepare final voting lists and databases required for meeting registration.[267] When the issuer elects to hold its meeting out-of-town (for example, the banks routinely move their meetings across the country, while their head office and the office of the transfer agent that services them is in Toronto or Montreal), the transfer agents advise that they need time to travel and set up in that location after the proxies are all counted and the voting list run. In addition, some time may be required to reconcile anomalous voting results or to resolve issues such as over-voting.[268]

The proxy cut-off time is effectively shortened for the OBOs (and the NOBOs if Broadridge is doing the mailing) because Broadridge requires voting instructions to be received by it at least one business day before the proxy deposit date (to enable it to incorporate the vote into its results and provide the results to the tabulator prior to the proxy cut-off time). In addition to reducing the voting time by an additional 24 hours, the fact that the VIF deadline differs from the proxy deadline can lead to confusion because, while the proxy circular may highlight the need to return the form of proxy by the proxy cut-off time, the disclosure about when a VIF needs to be deposited in order for the vote to be counted is not always clear or apparent. Typically, the circular states only that the VIF must be returned "in time" for the intermediary to vote and it is only if the beneficial holder reads the detailed instructions on the VIF itself that the shorter voting deadline is highlighted. Vote tabulation reports are often not provided by Broadridge prior

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266 CBCA, s. 148(5). Similar provisions exist in *Business Corporations Act* (Alberta), R.S.A. 2000, c. B-9, s. 148(5); *The Corporations Act* (Manitoba), C.C.S.M. c. C225, s. 142(5); *Business Corporations Act*, S.N.B. 1981, c. B-9.1 s. 91(5); *Corporations Act* (Newfoundland), R.S.N. 1990, c. C-36, s. 249; *Business Corporations Act* (Northwest Territories), S.N.W.T. 1996, c. 19, s. 150(5); *Companies Act* (Nova Scotia), R.S.N.S. 1989, c. 81, s.85B(5); *Business Corporations Act* (Nunavut), S.N.W.T. 1996, c. 19, s. 150(5); OBCA, s. 110(5); *The Business Corporations Act* (Saskatchewan), R.S.S. 1978, c. B-10, s. 142(5); *Business Corporations Act* (Yukon), R.S.Y. 2002, c. 20, s. 150(5).

267 Computershare, "Proxy mailing and meeting planner", online: <https://www-us.computershare.com/marketing/na/proxy_site/pdf/latest_ppg.pdf>.

268 In the Canadian system, a proxy cut-off time may be necessary for a variety of reasons, many of which result from the fact that many of the transfer agent's processes are paper-based.

to the cut-off time due to system constraints, and an issuer may acknowledge and accept reports delivered shortly after the official cut-off time.

U.S. corporate statutes do not contemplate proxy cut-off times and, in fact, votes continue to come in throughout the meeting. However, under this system, the final results of the vote may not be known for several days. The inspector of elections takes the proxies and ballots after the meeting and renders its report when it has had time to deal with those materials and the issues they raise thoroughly.

However, the fact that each issuer may set the proxy cut-off time, means that the individual investor must keep track of this cut-off time for every issuer in which it has invested.

It is clear from the foregoing that a fairly simple step in addressing at least some of the concerns outlined above would be to require clear disclosure of the VIF cut-off in an issuer's circular. This would help reduce the confusion as to when a VIF must be received. Consideration should also be given as to whether a prescribed cut-off period should be mandated or whether there is a sound basis for providing discretion through its by-laws to an issuer to fix the proxy cut-off – or a cut-off that applies to all voting instructions, whether they are given through proxies or VIFs. While the use of a cut-off appears to facilitate the conduct of a meeting by providing the issuer and tabulator with time to address potential issues in advance, it is unclear why discretion is afforded to the issuer in fixing, extending and waiving the cut-off time.

30.2 Problems With the Way in Which the Proxy or VIF Has Been Completed

Investors must provide certain information in order to give effective voting instructions. When that information is missing or is in some way deficient, the proxy or VIF may be rejected. Many of these issues relate to proxies and VIFs that are completed manually (as opposed to electronically by telephone or computer).[269]

Very few of these issues arise when proxies or voting instructions are provided electronically. The process can be set up to mandate completion of a particular field before the investor can move on to the next item, making it almost impossible for an incomplete form to be submitted. "Radio buttons" also prevent contradictory instructions – if the investor marks "for", that field will be voided if the investor then marks "against" instead.

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[269] "The Hanging Chads of Corporate Voting" deals with the U.S. proxy voting system. See Marcel Kahan & Edward Rock, "The Hanging Chads of Corporate Voting" (2008) 96 Geo. L.J. 1227 [Kahan & Rock]. "Hanging chads" is a reference to the votes cast in the controversial U.S. presidential election in which George W. Bush ultimately secured a narrow win over Al Gore. "Hanging chads" refers to deficiencies in the punchcard voting systems used in the United States. Canadian federal elections continue to use only paper ballots and have not experienced any examples of similar issues surrounding the elections.

Another problem can occur when the voting instruction or proxy is not submitted with the correct name. This is reported to have been the case when certain votes were not counted in connection with the 2005 vote on the Molson-Coors merger. After the vote results were announced, Highfields Capital Management, a Boston investment management firm, concluded that its votes were not reflected in the count. Highfields held 1.2 million (6 percent) of the Class B stock. Highfields stated that its custodian had confirmed that its shares were properly voted,[270] but transfer agent CIBC Mellon Trust reported that Highfields was not properly registered to vote.

30.3 Systems Problems and Human Error

Problems can always arise either with the computer systems being used or through human error. This section sets out a number of non-public examples.

30.3.1 Withhold Votes for Directors (Yahoo!)

One very public example of voting results being calculated incorrectly in the United States occurred at the Yahoo! 2008 annual meeting. The voting results as originally reported showed a 14.6 percent withhold vote for Yahoo! CEO Jerry Yang. This result seemed odd to two large funds that held a significant position in Yahoo! (6.5 percent and 9.8 percent, respectively), since their proxy committees had both recommended withhold votes from two directors, including Mr. Yang. A recount resulted in the withhold count for Mr. Yang being 33.7 percent (not the 14.6 percent as originally reported). The explanation was a truncation error at vote tabulator Broadridge Financial Solutions that occurred "when shares withheld for a specific director in a specific nominee exceeded eight digits and were reported to the tabulator in paper format". Broadridge later reported that it had determined that the situation was unique and that it had verified that over the past 18 months there were no other meetings with reports that included this unique combination of factors.[271]

30.3.2 Related Party Transaction (Gateway Casinos)

In 2006, unitholders of Gateway Casinos Income Fund approved a related party transaction. The resolution was approved on the basis of 52.4 percent of votes cast. Following a review of the voting results requested by a unitholder, Gateway Casinos issued a press release stating that there were "errors made by the scrutineer in connection with the tabulation of votes."[272] The errors included a "failure to record certain negative proxies, which had they been included, could have resulted in the resolution not passing."[273] The company added that there was "another tabulation error which could have offset the impact of these negative proxies depending upon the manner of

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270 Sean Silcoff, "Molson Coors is finally on tap: merger of equals clears last hurdle" *The Gazette* (Montreal) (3 February 2005) B5.

271 Kara Swisher, "Broadridge to Yahoo: oops we added wrong" (5 August 2008), online: Yahoo Finance <http://finance.yahoo.com/tech-ticker/article/44823/Broadridge-to-Yahoo:-Oops,-We-Added-Wrong>; see statement from Chuck Callan, Senior Vice President Regulatory Affairs at Broadridge Financial Solutions.

272 Gateway Casinos Income Fund, Press release (5 June 2006), online: <http://sedar.com>.

273 *Ibid*.

its resolution."[274] According to the chief financial officer of Gateways Casinos, the error was caused by an internal procedure used by its transfer agent.[275] The transfer agent acknowledged the error, noting that it was an isolated incident.[276] The trustees of Gateway Casinos, including the independent trustees who reviewed the problem separately with legal counsel, determined that the results at the meeting made by the chair of the meeting were in good faith and were based upon the advice provided to him by the transfer agent. On that basis, they determined the vote in favour of the related party transaction remained valid. Gateway did not disclose what the vote result would have been in the absence of the tabulation errors.

30.3.3 Proxy Battle (EMS and Frank D'Addario)

In a 2005 proxy battle between Environmental Management Solutions Inc. (EMS)[277] and its founder, Frank D'Addario, Mr. D'Addario's slate lost in a very close vote (50.35 percent for the management slate vs 49.65 percent for Mr. D'Addario's slate). Mr. D'Addario disputed the results. Affidavit evidence provided by Broadridge (then called ADP) revealed a systems problem that caused votes received in the 14-hour period immediately prior to the proxy cut-off time to not be counted. The error was caught by Mr. D'Addario's proxy solicitation agent and the votes were allowed by the meeting chair, even though they had technically arrived after the proxy cut-off time. [278] An Ontario court[279] upheld the chair's decision. The systems problem involved a file relating to an entirely different shareholder meeting. However, the problem with that file effectively blocked the system and prevented it from processing the EMS file that followed it.

30.3.4 Special Meeting to Remove Directors (Southam and Conrad Black)

In 1996, after acquiring effective control (41 percent) of the shares of Southam Inc., Conrad Black called a special meeting and succeeded in removing from the Southam board, five independent directors who he famously referred to as the "obdurate rump". At the time, Trimark Investment Management Inc. ("Trimark") owned more than 7.5 million, or just under 10 percent, of Southam shares. As a result of an administrative error,[280] Trimark's dissenting votes were not counted in the final tabulation (although this would not have affected the final result).

It is also possible for votes to be counted incorrectly or not at all when they are being processed manually. Human error can occur not just in the voting of the proxies, but also in the way in which they are marked or sent in. Many institutional investors provide their voting instructions to a proxy advisory service that sends those instructions to Broadridge or the transfer agent on behalf of the investor. We have heard anecdotally about several experiences where the proxy advisory service did

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274 *Ibid*.

275 Carrie Tait, "Gateway Casinos warns of miscount: expects Langley deal to stand" *National Post* (6 June 2006), FP11.

276 We understand that this resulted from a human error.

277 Environmental Management Solutions Inc. [EMS].

278 Kingsdale was acting for Mr. D'Addario.

279 *D'Addario v. Environmental Management Solutions Inc.*, [2005] O.J. No. 3008 (S.C.J.).

280 Jonathan Chevreau, "Trimark opposed Southam shuffle" *The Financial Post* (8 August 1996), (Lexis).

not execute its client's voting instructions properly. The problem is only discovered when a proxy solicitation firm follows up with an investor to determine why a vote that they expected would be cast in favour of their client does not appear to have been cast.

30.3.5 Other Examples

Certain issuers and investors have shared their experiences with us and are allowing us to describe these experiences in this paper on a no-names basis.

In one case, an investment manager called an issuer following the annual meeting to say that they held a large position in the issuer and that they had withheld their vote from one of the nominees to the board. Based on the reported results, the investment manager did not believe its votes had been counted. The issuer was able to determine that the investment manager had properly instructed the custodians holding its position and that the custodians had properly transmitted their client's voting instructions to Broadridge. The voting instructions were not received by the issuer's transfer agent, who was acting as official tabulator and scrutineer. Ultimately, it was not possible to determine why they had not been received. Had the votes been counted, the withhold vote from the director in question would have been 4.4 percent on one class of shares (rather than 0.3 percent) and 1.5 percent on the total number of issued and outstanding voting shares (rather than 0.1 percent).

In another case, an issuer's proxy solicitor suspected that an institutional investor had not yet voted its position. The institutional investor had undertaken to support management's recommendation in respect of a matter on which the vote was expected to be close. As the meeting date approached, the proxy results did not seem to reflect the institutional investor's position having been voted in favour of management. After some investigation, it became apparent that the proxy advisory firm through which the institutional investor voted had coded the institutional investor's voting instructions incorrectly and had voted against rather than for the management proposal. The mistake was ultimately corrected.

31 What Could Cause A Vote to Be Counted More Than Once?

31.1 Securities Lending

Securities lending is generally thought of as being the main reason that an intermediary is in a position where it has voting instructions that exceed the votes available to it through an omnibus proxy. The SEC Concept Release refers to a variety of approaches used by some intermediaries in the United States to reconcile their positions to address the over-voting that can result from securities lending. We are not aware that the intermediaries in Canada engage in any similar forms of reconciliation, making the chances that securities lending will result in duplicate or multiple voting more likely.

To assist with over-voting problems, Broadridge offers an over-vote reporting service. In order to receive this service, however, intermediaries must subscribe. For subscribing firms, Broadridge will compare the reported position to the depositary position, highlight any discrepancies, and enable the intermediary to make appropriate adjustments.

Over-voting played an important role in the 2008 proxy contest between Biovail's incumbent board and Eugene Melnyk's proposed slate. Shortly before the shareholder was to start, 6.3 million votes for the incumbents were revoked. Believing that this reflected a shift in investor sentiment, Mr. Melnyk did not attend the meeting, leaving it without a quorum. The cause of the sudden revocation of a significant number of shares was ultimately determined to be the correction of an over-vote.[281] A court subsequently ordered that the meeting be re-held.[282]

Another over-voting situation related to the shareholder meeting of IAMGOLD Corporation on July 6, 2004 in connection with its proposed (and ultimately failed) merger with Wheaton River Minerals Ltd. The day before the meeting, IAMGOLD discovered that it had an over-vote of approximately 26 million shares, for the most part from proxies deposited by Goldman Sachs and Morgan Stanley. When the issue was finally resolved, the transaction was rejected by a margin of 16 million votes.

31.2 Brokers Voting NOBO Positions After a NOBO Proxy Has Been Issued

We understand that,[283] in some cases, intermediaries vote the NOBO positions even after they have issued a NOBO omnibus proxy for their entire NOBO position to the issuer. This may occur, for example, where a NOBO has not received or has misplaced its VIF and calls its intermediary for assistance with voting. Recognizing that many of its OBO clients may not vote, the intermediary may accommodate its NOBO investor and send in its voting instructions. If the intermediary advises Broadridge that this has occurred, then Broadridge can reduce the NOBO omnibus proxy. If it does not, then no one other than the intermediary will know that this has occurred.

32 How Are Voting Issues Resolved?

32.1 Going Back to the Source

Where Broadridge is aware that an intermediary is in an over-vote position, it will typically go back to the intermediary to resolve the issue. Where this is not possible, Broadridge will, based on instructions from the intermediary, adjust the voting instructions received (for example by pro-rating all voting instructions) to align with the number of votes represented by the proxy Broadridge is submitting.

Broadridge will not necessarily be aware of the intermediary's position in DTC (although the intermediary will be aware of it). Accordingly, sometimes the over-vote does not become apparent until after Broadridge has delivered the omnibus proxy for a particular intermediary to the transfer agent. If time permits before the proxy cut-off date, the transfer agent may call the intermediary to try to resolve the situation. Otherwise, the transfer agent will ask the meeting chair for direction on how to deal with the over-vote.

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281 We are advised by the IIAC that the over-vote was identified by Broadridge and that after Broadridge contacted the dealer, the dealer contacted the counterparties and the situation was straightened out. The IIAC notes that this is an example of the system self-correcting.

282 *Wells v. Melnyk (2008)*, 92 O.R. 3d 121 (S.C.J.).

283 Information comes from STAC.

32.2 STAC Proxy Protocol

The STAC Proxy Protocol deals with eight categories of issues that commonly arise in connection with proxies.[284] The protocol sets out a general presumption in favour of accepting proxies and giving effect to the security holder's intention where possible. It further provides that any outstanding issues of uncertainty regarding proxy validity should be referred by the scrutineer to the chair of the meeting. It is the chair who has final determination over proxy admissibility, subject only to overruling by a court.[285]

While some of these guidelines are prescriptive in nature (e.g. a signature that is manually printed or executed in pencil is presumptively acceptable), others require the scrutineer to exercise discretion. For example, where a signature is not in the space provided by the proxy, it is acceptable if the person signing could reasonably be believed to have intended to execute the proxy. It is up to the scrutineer to reasonably infer the intention of the shareholder.

Broadridge has advised us that it follows the STAC's proxy protocol guidelines with respect to many issues. Of course, it is not required to do so and is not in any event required to disclose to the issuer, or to the investor how, it deals with any instructions it may have received from that investor.

32.3 Discretion

Two main themes emerge from a review of the way in which votes are actually counted. The first has already been discussed – the fact that there is very little, if anything, in the way of legal requirements. The corollary is that there is a good deal of discretion in the system at various points. How that discretion is exercised will depend, of course, on the circumstances. The result is that investors can be treated differently, depending on the circumstances. One example is in the approach to pro-rating when there is an over-vote situation. Broadridge advises that when their intermediary clients instruct them to pro-rate votes, that the proration is typically done across all the VIFs that Broadridge is tabulating for that intermediary. However, if the transfer agents have done the NOBO mailing, they may pro-rate only the OBOs on the theory that they know with certainty who the NOBOs are[286]

Transfer agents are, of course, retained by and take their direction from the issuers (subject to their own professional standards). There is, at least in that relationship, accountability to the issuer. Broadridge is, of course, accountable to its intermediary clients (who also operate within their own professional standards) who are in turn accountable to their own clients – the investors. However, the issues which seem to have the largest impact – such as over-voting – are not issues that can be traced back to the investors; they are problems that originate with the intermediary and can only be addressed there.

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284 Securities Transfer Association of Canada, "Proxy Protocol" (May 2007), online: <http://www.stac.ca/Public/PublicShowFile.aspx?fileID=110>; Issues Relating to Signatures and Holders; Instructions to Proxyholder; Form of Proxy; Date of Proxy; Missing Information; Revocation; Number of Securities Voted.

285 *Ibid*.

286 *Ibid.*

Ultimately, discretion over whether votes are counted is with the meeting chair, which is discussed in the next section. In that case, the issue is more one of independence than one of transparency or accountability.

33 Rulings at the Meeting

The chair of the meeting plays an important role in the ultimate outcome of the vote. This section discusses the role of the chair and the scope which he or she has to exercise discretion.

33.1 Duties of the Chair

After the votes have been tabulated, the shares represented by proxies still remain to be voted at the meeting by the applicable proxyholder. The chair's duties and powers include the duty and power to decide who is entitled to vote at the meeting.[287] This includes decisions as to the validity of proxies that are intended to be presented and voted upon at the meeting by proxyholders.

In making such decisions, the chair will be subject to a duty that the Supreme Court of Canada has considered in detail.[288] The Supreme Court stated that the duty of the chair is one of honesty and fairness to all individual interests, and is generally directed toward the best interests of the company. For purposes of a shareholder meeting, the best interests of the company centre solely on the maintenance of the integrity and propriety of the voting procedure.

33.2 Conflict Arising From Identity of Chair

The context in which the duties of the chair are applied is one of inherent conflict of interest.

Typically, the by-laws of a company designate the chairman or president of the company as the chair for a shareholder meeting, or in his or her absence, another officer of the company. Some corporate statutes specify that in the absence of any such designation in the articles or by-laws of a company, the president or, in his or her absence, a vice-president who is a director shall preside as chair at a shareholder meeting.[289]

In most matters voted on by shareholders, especially in the context of contested matters, there will be a real or perceived conflict of interest regarding a chair who is also an incumbent director or a member of management of the company. Although some courts have stated that a chair is under a quasi-judicial duty, the Supreme Court of Canada noted that a chair typically cannot labour under a strict quasi-judicial duty because the term conveys the idea of a wholly disinterested person. The Supreme Court noted that shareholders effectively agree to an arbiter who may have an interest in the decision by approving or sanctioning bylaws that provide for an incumbent director or officer to act as chair.

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287 *Bluechel v. Prefabricated Buildings Ltd.*, [1945] 2 D.L.R. 725 (B.C.S.C.).

288 *Blair* v. *Consolidated Enfield Corp.*, [1995] 4 S.C.R. 5.

289 OBCA, s. 97(c).

It is in this context of shareholder-sanctioned conflict of interest that the duties of fairness and the maintenance of the integrity and propriety of the voting procedure are applied. In addition, the obligation to promote fairness is tempered with the need to control and organize a meeting so that it proceeds effectively. The Supreme Court noted that courts have been reluctant, with the benefit of hindsight, to find chairs to be in breach of their duties barring proof of bad faith. In addition, courts have been reluctant to require that an independent person act as chair for a contested meeting solely on the basis of a conflict of interest of the appointed chair where there has been no act or omission which has created a reasonable apprehension that the meeting will not be conducted properly.[290]

33.3 Decision Maker of First Instance

As the chair is the decision maker of first instance regarding the validity of proxies, his or her decision will govern unless the affected party commences subsequent court proceedings and is successful in such proceedings.

In one case, the chair, who was the president and a director of the company, ruled that proxies presented by a dissident group that sought to elect the dissident's nominee as a director in his stead could only be used to vote in favour of management's slate of directors. The chair made this ruling on the basis that the proxies presented by the dissident group did not specifically name the dissidents' nominee and the instructions in the form of proxy restricted the proxyholders to voting for the management slate in the absence of any specification otherwise. The dissidents filed an application to overturn the ruling of the chair and were successful before the court.[291]

In another case, the chair, who was the chairman of the board, disallowed proxies presented by dissident shareholders seeking to remove the incumbent board and to elect nominees of the dissidents on the basis that the dissident proxy circular used to solicit such proxies was misleading. The dissidents applied to the court and the court agreed that the chair's actions were incorrect. The court found that although the circular was misleading in many material aspects, management of the company should have requested that the dissidents correct the misleading disclosure prior to the meeting. The court held that the chair's actions did not promote the integrity of the company's voting procedures.[292]

33.4 Transition to Virtual Meetings

In addition to permitting electronic delivery of proxy materials to shareholders, the corporate law also permits shareholder meetings to be held either with electronic participation or wholly by electronic means, the caveat in each case being that the electronic means must permit all participants to communicate "adequately" with each other during the meeting. To the extent that a shareholder participates electronically, the corporate statutes deem the shareholder to be present at the meeting. The corporate law also provides that while generally voting at a meeting shall be by a show of hands (except where a ballot is demanded and unless the issuer's by-laws

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290 *Proprietary Industries Inc. v. eDispatch.com* (2001), 30 B.L.R. (3d) 87 (B.C.S.C.).

291 *Canadian Express Ltd. v. Blair* (1989), 46 B.L.R. 92 (Ont. S.C.).

292 *Kluwak v. Pasternak* (2006), 26 B.L.R. (4th) 215 (Ont. S.C.J.).

otherwise provide), voting by those shareholders participating electronically in the meeting may be effected by means of any telephonic, electronic or other communication facility provided by the issuer.

In the United States, advance Internet voting and annual meeting webcasts have been common for several years, although shareholders were not able to vote live at company meetings via the Internet and were not able to ask questions unless they attended the meeting in person or companies made arrangements for them to submit questions beforehand or via a webcast. Intel Corporation, a U.S. NASDAQ-listed company, was the first U.S. company to enable all of its shareholders to attend, ask questions and cast their votes live on the Internet at its annual meeting held May 20, 2009. Intel had previously allowed questions via the Internet, but had no way to limit online questions to validated investors only. However, at the May 2009 meeting which webcast live, shareholders were able to vote electronically and submit questions during the meeting. Intel had intended to go one step further and hold its 2010 annual meeting as a virtual shareholder meeting to the exclusion of an in-person gathering using technology provided by Broadridge. Bowing to shareholder concerns that virtual-only meetings would further disenfranchise shareholders, Intel held its annual meeting on May 19, 2010 as a hybrid form of meeting, allowing investors to participate either through the Internet or in person.

Listen-only webcasts of annual general meetings also occur in Canada.[293]

34 Disclosure to Investors About the Proxy Voting Process

34.1 General

The regulatory requirements relating to disclosure of the way in which the voting process operates are very limited and relate primarily to registered shareholders, not to beneficial owners that constitute the vast majority of investors. This is apparent from the fact that issuers and their advisors spend a good deal of time ensuring that the form of proxy complies with all legal and regulatory requirements. However, most investors do not receive the form of proxy; instead, they receive a VIF which, while it may be similar in appearance to the form of proxy, is not required to comply with the same legal requirements. This section discusses both of these issues.

34.2 Disclosure Obligations About the Process

Proxy solicitation is dealt with in both the corporate law and securities legislation.[294]

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[293] Issuers who have staged such webcasts include Methanex, Dundee REIT, Astral Media Inc., Encana, BCE, CML Healthcare, TSX, CGI Group Inc. and RioCan.

[294] NI 51-102, Part 9, "Proxy Solicitation and Information Circular" deals with the disclosure requirements relating to shareholder meetings.

An issuer is required to include, in its information circular, the following disclosure with respect to proxies given by registered holders:

- whether the person or company giving the proxy has the power to revoke it;
- if any right of revocation is limited or is subject to compliance with any formal procedure, a description of the limitation or procedure;
- whether the solicitation is being made by:
  - management (and if so, any director who has informed management in writing that he or she intends to oppose any action intended to be taken by management at the meeting); or
  - by another person (and the name of that person); and
- who is paying for the solicitation.

In addition, the circular or the form of proxy must indicate in bold-face type that the securityholder has the right to appoint a person or company to represent the securityholder at the meeting other than the person or company, if any, designated in the form of proxy (and must provide instructions as to the manner in which the securityholder may exercise that right).

There is no equally detailed requirement for an issuer to disclose the manner in which beneficial owners exercise their right to direct the voting of the shares in which they have an interest. The securities rules simply require the issuer to "explain in plain language" how an investor may exercise the voting rights attached to its securities, including the right to attend and vote at the meeting. There is wide disparity in the level and accuracy of disclosure of the non-registered investor voting process – one issuer refers to the "form of proxy" provided by the intermediary to the investor with the proxy materials, when in fact the investor will have received a VIF from the intermediary. Others require the VIF to be returned to the depository when it should be returned to the intermediary or Broadridge. Some circulars have more extensive and accurate disclosure, but still confuse the form of proxy with the VIF. Also, the process for having the investor appointed as the proxy of the intermediary so that the investor can vote at the meeting is routinely inaccurate in the circulars reviewed. It is difficult to expect the average investor to find such disclosure useful and the typical lawyer's practice of using precedents to draft proxy circulars ensures that these inaccuracies and errors in circulars get replicated from year to year and between issuers. In most cases, this disclosure is limited to advising the beneficial owner that it must follow the voting instructions provided by its intermediary, both in order to vote and to change that vote. It does not generally include any disclosure about what those instructions are. Some issuers also caution beneficial owners that, unless they follow the steps outlined on the VIF, they will not be entitled to vote at the meeting.

It is not surprising that there is no uniformity in this type of disclosure, since the process by which a beneficial owner provides voting instructions to its intermediary is not prescribed nor is it under the control of the issuer. In theory, a beneficial owner could provide those instructions in any form it chooses. Alternatively, each intermediary could send its own request form to its clients in order to obtain those instructions. In practice, of course, a single type of VIF is used by almost all intermediaries, since intermediaries typically outsource to Broadridge the request for voting instructions from their clients. Where the issuer or the transfer agent is responsible for mailing to NOBOs, the form of VIF will vary again.

Given that the vast majority of investors are beneficial owners, would it not make sense to devote the same regulatory care and attention to the process by which beneficial shareholders vote as has been the case for registered shareholders? The absence of any relationship between the issuer and the intermediaries who hold shares on behalf of their clients makes it particularly difficult for the issuer to provide any meaningful disclosure on the proxy voting process for beneficial shareholders, since each intermediary may communicate with its clients in the manner it chooses. For this reason, it appears that a far better solution would be for securities regulators to prescribe the form of VIF and the disclosure that must appear in the circular in keeping with a refreshed and easily understood voting process. Although Broadridge and transfer agents would have to adjust their processing software (high volume scanners are used to process VIFs) to recognize a new form, this should not be an insurmountable obstacle, especially if Broadridge and the transfer agents are given an opportunity to provide input into the regulatory process. Investors would then have a single form of VIF with respect to the issuers in which they have an interest and issuers would be in a position to describe the voting process relevant to all investors.

The Proposed Amendments to NI 54-101 contemplate amendments to the disclosure which address the issues technically, but not in fact. Under the proposed amendments, the issuer will be required to disclose if it does not pay for intermediaries to send proxy-related material to OBOs and that it is the OBO's responsibility to make arrangements with the intermediary to exercise his or her voting rights. This, of course, is circular, because if the OBO receives the circular, there is no problem. If the OBO does not receive the circular, the disclosure about why it did not is moot.

It is also important that any renewed system ensure that registered shareholders and unregistered investors be treated in the same way to the fullest extent possible.

34.3 Confirming the Vote

The nature of the existing process is such that vote confirmation is not possible for OBOs unless the SWIFT network is used from beginning to end. In circumstances where Broadridge is retained as the tabulator and also has been retained to deliver the proxy materials and report the proxy votes back to the issuer, Broadridge has the ability to confirm back to a beneficial owner that its vote has been processed. Where Broadridge is not the tabulator, there is no automatic confirmation or reconciliation between Broadridge and the tabulator.

34.4 Disclosing the Voting Results

Although most issuers are required to disclose the voting results from shareholder meetings, the actual percentage of votes cast for or against or withheld is not required to be disclosed unless the vote was conducted by ballot.[295] As a result, in many circumstances disclosing the result of the vote is limited to a pass/fail type of disclosure. This is because the corporate law provides that voting at a meeting is to be by show of hands unless a ballot is demanded by a shareholder or proxyholder. The value of disclosing the voting results is therefore somewhat limited, as shareholders may in many cases never know whether a resolution passed by 51 percent or 91 percent or some number in between - information which arguably could be important to an investor.

In its 2009 report on the timeliness and utility of the reporting of voting results in Canada,[296] the CCGG reported that 62 percent of the S&P/TSX Composite companies reported the number of votes cast in favour of each resolution, while all the rest of those companies that reported their results (two did not) did so on the basis simply of whether the resolution passed.

35 Possible Solutions

35.1 Audits of the System

A useful analogy is to the mutual or investment fund industry, which provides pooled investment opportunities to the public, often through entities that have little embedded governance structure, such as trusts and partnerships. The mutual funds industry routinely outsources parts of its activities, such as custodianship of securities. The mutual fund industry also routinely, as part of its risk management, requires third-party service providers to the industry to obtain Service Auditor's Reports as a condition of continuing to provide service. The CICA Handbook-Assurance Section 5970, "Auditor's Report on Controls at a Service Organization", provides guidance for auditors who issue audit reports on the processing of transactions by a service organization for user organizations and their auditors. Two types of reports may be issued: reports on controls placed in operation (often referred to as a "Type I report") and reports on controls placed in operation as well as on tests of the operating effectiveness of the controls (often referred to as a "Type II report").[297]

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295 NI 51-102, s. 11.3. The CBCA, s. 141 and the *Business Corporations Act* (Alberta), R.S.A. 2000, c. B-9, s. 140; *Business Corporations Act* (British Columbia), S.B.C. 2002, c. 57, s. 170; OBCA, s. 130 provide that votes may be cast by show of hands, unless a ballot is demanded by a shareholder eligible to vote at the meeting. The CCGG reports see *infra* note 296, that many issuers do not require shareholders to make that request and voluntarily report the ballot results.

296 Canadian Coalition for Good Governance, "The Timeliness and Utility of the Reporting of Voting Results 2009" online: <http://www.ccgg.ca/>.

297 Service Auditor's Reports are primarily used by the service organization, their clients, and the clients' auditors. The clients' auditors can use the report to gain an understanding of the internal controls in operation at the service organization. The Service Auditor's Report may also be used by customers, prospective customers, stakeholders and other interested parties to gain an understanding of the internal control environment of the service organization.

Broadridge provides participants an extensive program of external audits by a Big Four firm, for processing and tabulation. Reports are provided to regulators and key groups including, among others, SEC, NYSE, Society of Corporate Secretaries and Governance Professionals, Council of Institutional Investors, major custodian banks, major broker-dealers and large institutional investors. The reports are provided by independent public accountants and address vote accuracy, compliance with applicable NYSE/SEC regulations, Broadridge's operational performance, and data security. An independent review of the entire process is also conducted on an annual basis. Broadridge also provides a program of internal audits for processing and tabulation. Finally, an independent steering committee meets annually with the SEC and the NYSE. It is comprised of experts on shareholder communications and proxy voting who represent the interests of custodian banks, broker-dealers, institutional investors, and corporate issuers. It establishes performance evaluation criteria, monitors Broadridge's performance, and recommends ways to improve systems and processes for shareholder communication and proxy voting.

35.2 Independence of the Meetings

If one accepts that management (including the board) has an interest in the outcome of any shareholder meeting, then it is an interesting anomaly in a governance environment that prizes independence and transparency, that the method of dealing with votes is a management prerogative with no accountability to the investors for the way in which the votes are handled.

The STAC Proxy Protocol provides some guidelines where the law provides none, but in many cases, there is more than one possible outcome to frequently encountered situations. Issuers who are familiar with potential issues work closely with the scrutineer well before the meeting and before any issue needs to be referred to the meeting chair. Unresolved issues are ultimately referred to the meeting chair. The meeting chair is typically the chair of the board. Concerns about independence and transparency are of course heightened when there is a shareholder proposal, a contested director's election or special business that may be controversial.

We offer for consideration a proposal that meeting chairs be independent. In principle, this should be the case for all shareholder meetings. However, this may be impractical, given the number of public companies and the concentration of annual meetings in a three-month period each spring. As a start, it would be desirable for issuers to voluntarily engage an independent meeting chair whenever there is a contested election for directors. This could be extended over time to other meetings with controversial business.

We would not suggest that this suggestion be imposed by legislation, regulation or by the TSX. Rather, if the marketplace finds merit in these suggestions, issuers who are prepared to provide leadership in this area may voluntarily adopt them or investors may pressure issuers to do so.

PART VII – IMPACT OF FINANCIAL MARKET INNOVATION ON THE PROXY VOTING SYSTEM

We typically think of an investor's interest in a share as being income that the share may generate (usually through the payment of dividends) or in the profit that may result when it is sold. However, financial markets have created a number of other uses for shares that provide value to the investor. Securities lending and derivative instruments are examples. Both satisfy legitimate investment objectives of the parties involved.

Securities lending and derivative instruments can have adverse effects on the proxy voting system. Votes attached to a single share may be cast more than once (resulting in over-voting) or votes may be cast by someone having no economic interest in the issuer (empty voting) or having an interest that is adverse to the issuer's interest (negative voting).

Both over-voting and empty voting have the potential to seriously distort the results of a shareholder meeting. However, the solution to these problems must balance the desire for integrity in the proxy voting system with the rights of those who have invested in a share to use the innovations of the financial markets to derive as much value as possible from that security. In other words, the optimal solution to over-voting is not to prohibit or to disapprove of securities lending, but rather to ensure that the vote attached to a share that has been loaned is voted by the borrower or by the lender – but not by both. The solution to empty voting and negative voting is more elusive. A first step is disclosure by those who seek to influence a shareholder vote of every interest they have in the securities of those issuers. A more difficult question to answer is whether there should be a prohibition of some sort on the use of securities lending programs or derivative instruments to cast votes that are not connected to an economic interest in the welfare of the issuer.

Over-voting is described in the first section of this part. However, because workable solutions to over-voting cannot be developed without first understanding how securities lending works, we offer a short primer on securities lending in the first section. In the second section, we discuss empty voting, which arises both through over-voting and through the use of derivative instruments. In order to contribute to workable solutions for empty voting, we also offer in that section a short primer on derivative instruments. The final section of this part is devoted to responsible shareholding – the concept that large wealth pools have an obligation to the capital markets not to engage in activities that compromise the integrity of the capital markets, including contributing to over-voting and empty voting by participating in certain practices that could contribute to those problems.

36 Over-Voting

Over-voting occurs where the vote attached to a share is voted more than once. That term is typically used when the custodian of the shares involved (e.g. the broker) casts votes that exceed in number the aggregate position it holds on behalf of its clients. However, this does not capture the full extent of the issue; the fact that many investors do not vote, in fact, disguises the extent of the problem. Shares may be voted more than once (multiple voting) before a broker is in a position of over-voting its entire position. This is possible because not all shares are voted. In

this section, we first explain securities lending and then go on to explain how multiple voting and over-voting occurs as a result of the practice of securities lending.

36.1 A Short Primer on Securities Lending

36.1.1 The Market

Securities lending represents a significant market. CIBC Mellon reports that, at the end of October 2008, there were approximately $902 billion of assets available for lending in Canada, of which approximately $109 billion were on loan.[298] Globally, there were $11 trillion of assets available for lending with $2.3 trillion on loan at the end of October 2008.[299]

36.1.2 Why Lend? Why Borrow?

The "lender" in a securities lending transaction is either an investor or an intermediary who has a position in a particular security which it expects to continue to hold until the position is sold. Rather than simply holding the position, the lender can earn a fee by "lending" some of its position.

The "borrower" in a securities lending transaction is a person who wants to have a position in a security for a period of time for reasons other than making an investment in that security. Market makers are one example. The TSX assigns a broker-dealer to be the market maker for each listed security. That broker-dealer displays buy and sell quotations for a guaranteed number of shares. If the market maker receives an order for shares at the sell price it has quoted, it may be able to offset that order with an order from another customer who wishes to buy at the price it has quoted. Where there is no offsetting order, the market maker will sell from its own inventory. Where this is not sufficient, it may borrow shares in order to settle that trade.

Arbitrageurs are another example. In order to execute on a particular strategy (by which the arbitrageur takes advantage of inefficiencies that give rise to price differences in different markets for an identical security), the arbitrageur may need to hold a position in a security temporarily (for example, a position in a security in one market where the share is underpriced in order to sell it in another market at a higher price).

Short sellers are a third example. They borrow shares and sell them into the market, then repurchase the shares at some point in the future to return the shares to the lender or "repay the loan". Some short sellers are motivated by a belief that the price of the shares will decline between the time they sell the shares and the time they repurchase shares in the market. If this happens, the difference between the higher price at which the short seller sold into the market and the lower price at which the short seller later purchased in the market (in order to return the shares to the lender) is a profit to the short seller. In other cases, a short sale is part of a

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298 James Slater, "Securities lending weathers the storm" *Trade Talk: Reporting on CIBC Mellon Initiatives and Developments Within the Securities Industry*, online: <http://www.cibcmellon.com/Contents/en_CA/English/NewsRoom/Publications/TradeTalk/EForms/TT_Spring%202009Final_EN.pdf>.

299 *Ibid*.

structured finance transaction designed to hedge against a risk or to finance another part of the transaction. The mechanics are the same as in the previous example of a short sale, but the motive for the short sale is necessary to provide certainty of the selling price and is not premised on a belief that the price of the shares will be going down.

36.1.3 The Mechanics of a Share-Lending Transaction

In a securities lending transaction, an investor or an intermediary (lenders on behalf of the investor) transfers its interest in publicly traded shares to the borrower. The borrower agrees to return an equivalent interest at some point in the future. The borrower may also agree to pay to the lender the equivalent of any distributions or dividends made with respect to the loaned securities while the loan is outstanding.[300] The borrower must acquire the security from a lender because it may be in the position of having to deliver that security to a third party (for example, to settle a trade). The transaction has the feel of a loan (and is in fact called a loan in the transaction documents and is booked as a loan for accounting purposes)[301] because the "borrower" eventually returns to the "lender" exactly what it acquired. This is possible because shares are fungible.

The borrower provides collateral for its obligation that have a value slightly in excess of the value of the loaned securities. The collateral is marked to market on a daily basis to reflect fluctuations in the market price of the security and the collateral (if other than cash).[302] That collateral may take the form of cash or marketable securities. Where the loan is collateralized with cash, the interest earned on the cash (which is held by the lender) is paid to the borrower (with some portion of that interest retained by the lender as a fee for the loan).[303] Where a securities loan is collateralized with securities, the lender receives a fee for the loan. Collateral is rarely shares, but rather cash or treasuries or other "near cash".

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300 These distributions are often referred to as "manufactured" distributions or dividends.

301 For tax purposes, under the *Income Tax Act* (Canada), R.S.C. 1985, c. 1 (5th Supp.) [ITA], a loan of securities which includes the voting rights to those securities will be treated as a deemed disposition. The general position for tax purposes is that a stock loan would, in the first instance, be expected to be treated as a sale given that the borrower has the full right to use the security, having only an obligation to return like property. This is then modified by the rather complex rules in s. 260 of the ITA known as the SLA (securities lending arrangements) rules, which deem qualifying transactions not to result in a disposition, and provide a framework for taxing the various components of stock loans. It may well be that the same transaction is treated differently depending on the purpose of the characterization and that there is nothing inherently wrong with this. Some brokers have systems in place which denote shares out on loan as "non-voting", although doubtless that would come as a surprise to some clients. At a minimum, brokers should be required to reconcile to their client and firm holdings against their lending ledger to ensure that the information provided to Broadridge does not include shares out on loan.

302 International Securities Lending Association, "Global Master Securities Lending Agreement" (July 2009), s. 5.4 online: <http://www.isla.co.uk/dynamic.aspx?id=58> and "Standard IIROC Securities Loan Agreement", s. 8.1.

303 This arrangement is called a "rebate for cash collateral".

As noted above, in a securities lending transaction, all of the indicia of ownership move from the investor whose shares are being loaned to the borrower under a securities lending agreement. This may include the right to vote those shares. In theory, if a record date for a shareholder meeting occurs while an investor's shares are out on loan, the investor loses its right to vote unless it has contracted to be able to recall the loaned shares or to require the borrower to vote in accordance with its instructions. Both of these provisions are found in the standard IIROC securities loan agreement. The agreement provides in part as follows:

> 5. Unless otherwise agreed,…Lender may terminate a Loan by giving notice to the Borrower establishing a termination date no earlier than the regular settlement date for trading in the Loaned Securities in the principal market in Canada…

It may not be practical in many cases for the lender to get the shares back in time for the record date. In addition, the IIROC form of agreement also provides that the lender may direct the borrower in the way in which the shares are to be voted:

> 7.6 Borrower acknowledges and agrees that all voting rights…accrue to the Lender as legal and beneficial owners of the Loaned Securities as if the Loaned Securities had not been lent by Lender to Borrower; and Borrower shall exercise all such rights and privileges on behalf of Lender in accordance with the written instructions of Lender. Such written instructions of Lender must be actually received by Borrower at least five (5) business days prior to the final date for the taking of any action required to exercise such right…

There are, however, many securities lending transactions that do contemplate the votes being cast or directed by the lender. For example, the International Securities Lending Association's Global Master Securities Lending Agreement (July 2009) provides in part as follows:

> Where any voting rights fall to be exercised in relating to any Loaned Securities of Collateral, neither Borrower, in the case of Equivalent Securities, nor Lender in the case of Equivalent Collateral shall have any obligation to arrange for voting rights of that kind to be exercised in accordance with the instructions of the other Party in relation to the Securities Borrowed by it or transferred to it by way of Collateral, as the case may be, unless otherwise agreed between the Parties.

Where this is the case, the lender (being the party with the economic interest in the share) will not be able to cast its vote. On the other hand, the borrower (who needed to hold the shares only temporarily and who therefore may have no interest in the economic well-being of the issuer or may want the price of the shares to go down) will be able to cast the vote. This results in empty voting or possibly negative voting, discussed in the next section.

36.2 How Securities Lending Results in Over-Voting

36.2.1 Securities Lending by Broker-Dealers

Broker-dealers may also engage in securities lending using the shares held in their clients' margin accounts. In a standard margin account agreement between a broker-dealer and its client, the client agrees that securities held in the margin account that are not fully paid or are not excess margin securities[304] may be loaned to the broker-dealer or loaned to others without the broker-dealer having an obligation to retain under its possession and control, a like amount of securities.[305] The standard margin account agreement further provides that, in connection with any securities loan, the client acknowledges that the broker-dealer lending the securities from the client's account may receive certain benefits to which the client is not entitled and that, under certain circumstances, the loans may limit the ability of the client to vote its securities.[306]

When a broker-dealer is considering lending securities, it looks to the aggregate position it holds in that security. This aggregate position will include the share positions in its clients' margin accounts which are available for lending, as well as the position it holds for its own account. Because shares are fungible, it does not matter to the broker (or to the borrower of the securities) which securities it lends (or borrows). There is really no need from the broker-dealer's perspective to allocate the lending position among various margin accounts or to its own position. Rather, the records of the broker-dealer will state only that a certain number of shares out of the aggregate share position held in the broker-dealer's name have been loaned. The broker-dealer's records showing the position held for its own account and for clients will not necessarily change. As a result, when Broadridge pulls the client list from the broker-dealer's system following the notice of record date, the broker-dealer's account will show that the margin account client has a position in the loaned securities. The account of the borrower's broker-dealer will show that the borrower has a position in the same securities.

The example below (depicted in Diagram 4) illustrates in more detail how multiple voting of the same shares can occur and how this can give rise to possible over-voting.

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304 "Excess margin securities" are margin securities in a client's account with a market value in excess of 140% of the amount the client owes the broker-dealer. This is the U.S. definition in Rule 15c3-3 of the *Exchange Act*; it is unclear whether the same definition applies in Canada. There is no definition in the RBC Agreement, *infra* note 305.

305 RBC Dominion Securities, "Client account agreements and disclosure documents" (June 2008) at s. 15.6, online: <http://www.rbcds.com/pdf/ClientAccountAgreementsandDisclosure.pdf>. Section 7.2(d) further states: "If your securities are not fully paid for or are not excess margin securities, we may lend any of your securities to any third party on terms we think are best. We may also use any of your securities to deliver against any other sale of securities we make, including a short sale. We may do so for a sale for your account or another client's account."

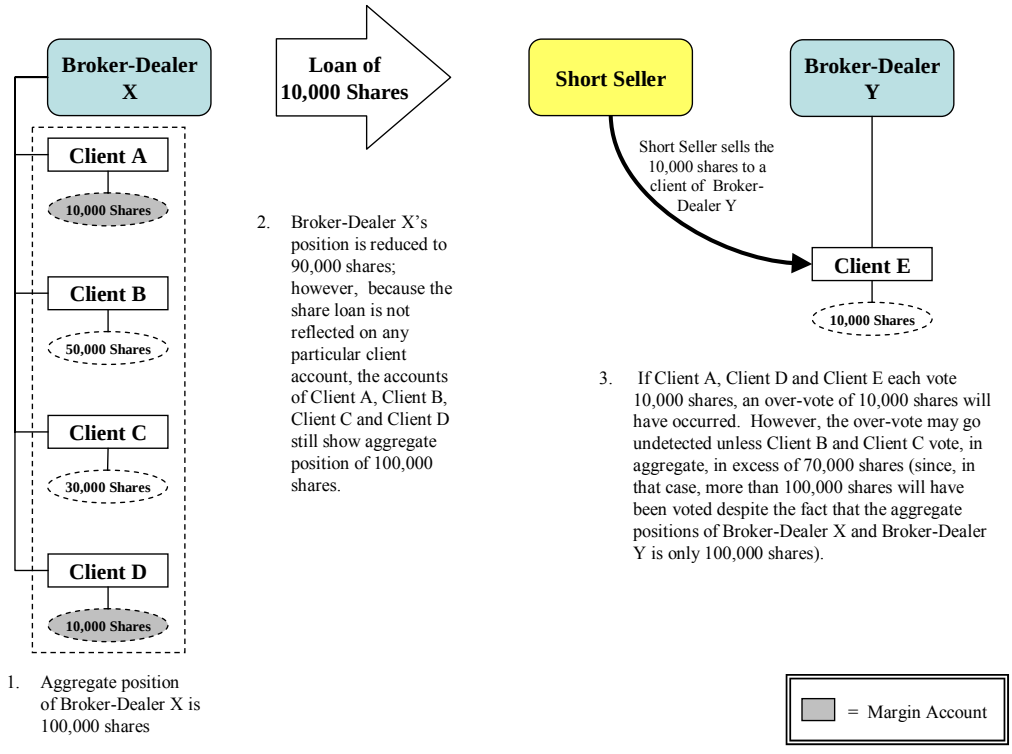
306 *Ibid*. at s. 15.7.

In this example, Client A and Client D both have margin accounts with Broker-Dealer X in which they hold 10,000 shares each of an issuer. Broker-Dealer X has an aggregate position (representing all shares of that issuer held by Broker-Dealer X) of 100,000 shares (the remaining shares being held as to 50,000 by Client B and 30,000 by Client C). Broker-Dealer X loans 10,000 shares of the issuer to Short Seller who subsequently sells the shares to a purchaser with an account at Broker-Dealer Y. A record date occurs before Short Seller repays the loan by transferring 10,000 shares back to Broker-Dealer X.[307]

The loan will be recorded on Broker-Dealer X's records as coming out of the aggregate position of Broker-Dealer X and will not be traceable to its own account or to any particular client account. The aggregate position of Broker-Dealer X within CDS will be reduced to 90,000 shares of the issuer. However, Broker-Dealer X's internal records will still show Clients A, B, C and D having an interest in 10,000, 50,000, 30,000 and 10,000 shares, respectively.

Based on the beneficial lists generated as at the record date, Broadridge will send voting materials to Clients A, B, C and D in respect of 10,000 shares, 50,000 shares, 30,000 shares and 10,000 shares, respectively, even though the aggregate position of Broker-Dealer X on CDS is only 90,000 shares. The records of Broker-Dealer Y will also show that its client has 10,000 shares.

Diagram 4: Example of Shareholder Loan Resulting in Over-Vote



307 If the borrower has a margin account, the process described above may repeat itself such that Broker-Dealer Y loans the shares to Short Seller 2 who then sells them to a person who has a margin account with Broker-Dealer Z. In fact, this process of on-lending and reselling could repeat itself numerous times in a very short span of time.

What effect does this have on voting? To isolate the problem, assume that Broker-Dealer X has no proprietary position in the securities in question and so the loaned securities are attributable to margin accounts of Broker-Dealer X's clients. As noted above, the loaned securities are not attributable specifically to Client A or Client D and so there is no basis on which to say that the right of either of them to vote should be reduced by 10,000 shares. Say that Client A and Client D both vote their entire position and Broker-Dealer Y's client also votes its position. Those 10,000 shares will be voted twice (once either by Client A or Client D and once by Broker-Dealer Y's client).

However, the fact that a multiple voting of shares has occurred will not be apparent unless the votes cast by Broker-Dealer X's clients exceed Broker-Dealer X's position. In our example, Broker-Dealer X has a position in 90,000 shares on the record date. If Clients A, B and D vote their entire position, but Client C does not vote, then Broker-Dealer X will have voting instructions with respect to 70,000 shares – well under its total position. However, if all of Broker-Dealer X's clients vote, it will have voting instructions with respect to 100,000 shares.

Where an over-vote situation occurs, Broadridge and the broker-dealer may be able to identify the source of the over-vote and correct it. In such circumstances, there is no legally prescribed set of rules which applies and a variety of different approaches may be used to rectify the over-vote and adjust the vote downwards to a number that matches the number shown as the broker's aggregate position in CDS. In some circumstances, this is where the mini omnibus proxy is utilized – to rectify an apparent over-vote when shares appearing in the name of one broker are actually being held for another broker. If the over-vote is identified by the tabulator (typically the transfer agent), it will resolve the issue using one of the approaches in the STAC Protocol (discussed above). While over-voting can have the undesired consequence of disenfranchising certain shareholders, it is entirely possible that the fact that shares may have been voted by a lender despite not being eligible to be voted will be invisible to the tabulator and the issuer. This is so because, in most elections, a significant number of shareholders do not vote their shares, thereby permitting the voting of ineligible loaned shares without exceeding the maximum number of eligible votes. This is also true of many critical shareholder votes.

The instructions on the Broadridge VIF points out to investors who hold through margin accounts that "…in the event that your securities have been loaned over record date, the number of shares we vote on your behalf has been or can be adjusted downward."

36.2.2 Institutional Investors

Many institutional investors hold their shares through custodians. The custodians run securities lending programs in which institutional investors may elect to participate. The custodians operate their securities lending programs in much the same way as brokers.

There are, however, several important differences. The custodians are lending these securities for the accounts of, and on the instructions of, their clients (subject to a fee charged by the custodians). Shares that are loaned are marked on the client's accounts as being loaned and the custodians therefore do not vote those shares on the client's behalf. One of the services provided by the custodian is ensuring that the shares which they hold are voted in accordance with the

instructions provided by their clients. A broker's position is typically not fully voted, but a custodian's position is, by definition, almost always fully voted.

The contracts between custodians and their clients may follow a standard form, but in some cases may be customized to meet the objectives of the clients. A client may, for example, stipulate that its interest may not be loaned out over a record date. If its shares are out on loan just prior to the record date, the custodian must either recall them or obtain other shares in the marketplace. In some cases, it may substitute another client into the securities lending program. In other cases, it may direct the borrower to vote the shares on the lender's behalf if a recall or a substitution is not possible. This may need to be written in the agreement.

We understand that there have been circumstances where institutional clients have been unable to recall their shares on loan on time for a particular vote and have, accordingly, been unable to vote their positions. As a result of this potential risk, some large institutions have opted to abandon their share-lending programs altogether, taking the view that the income generated by such a program is not sufficient to compensate for the risk that they may be unable to vote their shares.

36.3 NYSE Approach to Over-Voting

36.3.1 Oversight of Brokers

The NYSE[308] requires a broker to transmit proxy materials supplied by an issuer to the beneficial owners of stocks registered in the broker's name (so long as the issuer provides assurance for reimbursement of expenses) and to vote proxies for stock registered in its name (or in the name of its nominee) at the direction of the investor.

In Canada, the stock exchanges do not impose rules comparable to the NYSE rules described above, although the result of the NYSE is similar to the result of Canadian corporate and securities laws described elsewhere in this paper. However, the NYSE has engaged in active oversight of broker activities in this area that does not exist in Canada.

In a 2004 information memorandum, the NYSE disclosed that several special examinations of member organizations' proxy departments and a survey of proxy voting and related procedures had revealed significant areas of concern involving an apparent systemic over-voting of proxies and a general lack of supervision.[309] The NYSE noted that these problems arose for three reasons:

- failing to properly account for firm and customer short positions when calculating the firm's long position;
- incorrectly including shares which had been lent in the calculation of the firm's position; and
- having failed to correctly calculate the long position, then failing to utilize the proxy service agency's over-voting reports.

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308 NYSE Rules, Rule 451 and 452.

309 NYSE, Information Memo 04-58, "Supervision of Proxy Activities and Over-voting" (5 November 2004).

The NYSE noted that while most brokers have outsourced the gathering and voting of proxies, the member organizations remain responsible for "complying with the relevant regulations, supervising this process, maintaining adequate and accurate books and records, and ensuring that the rights of beneficial shareholders are protected". And further:

> The essence of avoiding over-voting is the assurance of the availability and accessibility of accurate security positions. While the comparison services provided by proxy service organizations are useful, they cannot take the place of careful checks against the accuracy of member organizations' own records.[310]

The NYSE Hearing Panel has consistently held that brokers violate NYSE Rules if they submit votes for more shares than they are entitled to vote.[311] Rule 452 requires a broker "to collect and *properly* transmit to a Tabulator, an agent of the issuer, any votes cast by Shareholders of the security for which proxies are solicited."[312] Over-voting constitutes an improper or inaccurate submission of votes because a margin account holder "forfeit[s] certain rights – including voting rights" when he, she or it agrees to allow their shares to be loaned out by the broker.[313] The NYSE Hearing Panel has held that when a broker lends out the shares of a margin account holder, the margin account holder is no longer the beneficial owner and so is not entitled to submit a proxy:

> [I]f stock in margin accounts has been used for stock loans, and both the margin account holder or holders and the recipient of the stock loan submit voting instructions for the same stock, then the margin account holder may submit a proxy for shares of which he is at that time not the beneficial owner, and for which he is not entitled to submit a proxy.[314]

Accordingly, compliance with Rule 452 requires a broker that lends securities held in clients' margin accounts to accurately adjust its record of stock ownership, and decrease the voting shares in affected margin accounts, prior to the submission of voting instructions to an issuer (or to the issuer's tabulator).[315] For example, in determining that RBC Capital Markets Corporation over-voted and breached NYSE Rule 452, the NYSE Hearing Panel stated:

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310 *Ibid*.

311 *In the matter of Credit Suisse Securities (USA) LLC*; NYSE Hearing Board Decision 06-54 (18 April 2006) [*Credit Suisse*]; *In the matter of UBS Securities LLC*, NYSE Hearing Board Decision 06-55 (18 April 2006) [*UBS*]; *In the matter of Goldman Sachs Execution and Clearing, L.P.*, NYSE Hearing Board Decision 06-61 (4 May 2006) [*Goldman Sachs*]*; In the matter of RBC Capital Markets Corporation*, NYSE Hearing Board Decision 06-131 (29 June 2006) [*RBC*]; *In the matter of First Clearing LLC*, NYSE Hearing Board Decision 07-28 (8 March 2007) [*First Clearing*]; and *In the matter of Deutsche Bank Securities Inc.*, NYSE Hearing Board Decision 05-45 (8 February 2006) [*Deutsche Bank*].

312 *Deutsche Bank*, *ibid*. at 9.

313 *Goldman Sachs*, *supra* note 311 at 17.

314 *Goldman Sachs*, *supra* note 311 at 12; Credit Suisse, *supra* note 311 at 13; UBS, *supra* note 311 at 11.

315 *RBC*, *supra* note 311 at 18; First Clearing, *supra* note 311 at 22.

> The Firm should have removed stock loans and short positions in a particular security and decreased the voting shares in its margin accounts prior to the Agent's submission to the Tabulator.[316]

Similarly, in the NYSE Hearing Panel's investigations of Credit Suisse Securities, UBS Securities LLC, Goldman Sachs Execution & Clearing L.P., RBC Capital Markets Corporation and First Clearing, LLC, the voting of shares that were out on loan was identified as a cause of the respective brokers' over-voting and corresponding breaches of Rule 452.[317]

36.3.2 Effect of Over-Voting

The general lack of transparency and reporting of lending transactions, together with the infrequency of over-voting, make it difficult to determine with any certainty how significant the risk of multiple voting is. Realistically, the potential adverse effects where there is no over-voting are limited to the theoretical possibility that a shareholder who was not entitled to vote could potentially distort the voting results where a vote is extremely close. Whether this is likely to have any impact on the outcome of votes is difficult to know. However, unless the number of shares involved is significant or a vote is extremely close, it seems relatively unlikely to have a material impact.[318]

Finally, it is our understanding that the risk of multiple voting is more likely to arise in retail accounts where the client remains unaware of the share-lending that goes on in the background. While the potential implications would be far greater if multiple voting occurred with the share positions held by large institutional investors (such as pension funds, mutual funds and insurance companies), we understand that this is far less likely because they hold their share positions with custodians in segregated accounts which enables these institutions to more easily track their share loans and make decisions as to whether to recall loans in order to exercise their right to vote. Very rough statistics indicate that 80 percent of publicly traded equities are held by institutions that represent about 20 percent of broker accounts. Conversely, retail accounts represent 80 percent of broker accounts, but only 20 percent of publicly traded equities.

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316 *RBC*, *supra* note 311 at 18.

317 Note that in *Deutsche Bank*, *supra* note 311 at 18, the over-voting and breach of Rule 452 were due to the firm's "erroneous issuance of duplicate requests for voting instructions to certain omnibus accounts".

318 In the *UBS*, *Goldman Sachs* and *Credit Suisse* hearings referred to *supra* note 311, the Hearing Panel noted that Enforcement's investigation did not disclose any instance in which an over-vote improperly affected the outcome of a proxy vote or any instance in which a shareholder who attempted to vote his or her shares was disenfranchised and lost his or her vote. See *Credit Suisse*, *supra* note 311 at 24; *UBS*, *supra* note 311 at 20; *Goldman Sachs*, *supra* note 311 at 21.

36.4 Response of Canadian Regulators to Over-Voting

Regulators have known about the problem of over-voting in Canada for a considerable amount of time.[319] Yet regulators have not taken action to prevent it. The proliferation of securities lending has exacerbated the potential problem of over-voting now associated with the failure of intermediaries to identify on their books client positions which are not supported by underlying registered positions.

In 1995, a committee tasked with investigating over-voting issues recommended that corporate law legislation be amended to require the setting of a record date for determining shareholders entitled to vote at a meeting of shareholders.[320] A related suggestion was that, in compiling their NOBO and OBO lists, intermediaries should be required to reconcile their clients' beneficial ownership positions against the aggregate underlying securities positions registered in the name of the intermediary or its nominees as of the record date for voting.[321] This would require the intermediary to deduct from a client's beneficial position securities that have been lent, unless the loan is recalled and the securities are "re-registered" in the name of the intermediary or its nominee. The CBCA now permits directors to set a voting record date (although for reasons of convenience, this seldom happens) but the recommendations relevant to intermediaries were never adopted.

Provisions designed to limit over-voting were included in the original version of the companion policy accompanying NI 54-101. It required an intermediary to be able to identify which of its clients were NOBOs, OBOs or other intermediaries, and specify the holdings of those clients.[322] The provisions, which were removed by regulators in the final version of the companion policy, sought to ensure that intermediaries' records reconciled with those of the other intermediaries, depositories, or issuers through whom it held its securities. The policy prohibited intermediaries from providing security position information which exceeded their total security holdings as reflected on the register of the issuer or in the records of the depositary when responding to requests for beneficial owner information.[323] The policy also stressed that the total number of

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319 A subcommittee of the Industry Implementation and Monitoring Committee for National Policy Statement No. 41 was formed in May 1995 to investigate over-voting issues and how they might be addressed. Further, in August 1995, Industry Canada circulated a paper "Shareholder Communications and Proxy Solicitation Rules" as part of Phase II reform of the CBCA; Industry Canada, *Shareholder Communications and Proxy Solicitation Rules* (Ottawa: Industry Canada, 1995). The paper acknowledged that the absence of a fixed record date for voting and loaned shares has the potential to cause problems for publicly traded corporations by creating additional possibilities for over-voting. The paper recommended allowing corporations to establish a fixed record date for voting shares and amending the CBCA to require that share loan agreements specify who had voting rights for the shares being loaned.

320 Memorandum from Robert F. Kohl to the Canadian Securities Administrators National Policy 41 Committee, "Re NP 41 Over-voting Subcommittee Observations, Conclusions and Recommendations", (5 October 1995).

321 *Ibid*.

322 *Notice of Proposed Changes to Proposed National Instrument 54-101 and Companion Policy 54-101CP*, O.S.C. CSA Notice, (17 July 1998).

323 *Ibid*.

votes cast at a meeting by an intermediary not exceed the number of votes for which the intermediary itself had a proxy.[324]

The SEC is currently collecting information from proxy participants on over-voting to determine whether further regulatory action should be considered. In their concept release on the U.S. proxy system, the SEC identifies the current reconciliation and allocation methodologies used by broker-dealers to address voting imbalances and potential regulatory responses. Even though SEC rules do not mandate that a reconciliation be performed, most broker-dealers have adopted a reconciliation method to balance the aggregate number of shares they are entitled to vote with the aggregate number of shares credited to customer and proprietary accounts.[325] The SEC is considering whether to make broker-dealers publicly disclose both the allocation and reconciliation method used during each proxy season, as well as the effect of that method on whether customers' voting instructions would actually be reflected in the broker-dealer's proxy sent to the vote tabulator.[326] Alternatively, the SEC is seeking comments on whether it would be beneficial to investors if broker-dealers were required to use a particular reconciliation method.[327]

37 Empty Voting

"Empty voting" occurs when an investor has the right to vote, but has reduced or eliminated its economic exposure to the stock. This can occur where a shareholder sells its shares after the record date and necessary steps have not been taken to transfer the shares to the purchaser (with the result that the right to vote remains with the vendor). It can also occur where a person has used a synthetic instrument to reduce or neutralize its economic exposure to the share. Finally, it can occur where a person holds a share temporarily for a purpose other than investing in the issuer (for example, the investor has borrowed the shares in order to cover a short position or the investor has acquired the shares temporarily in order to vote).

Negative voting is closely related to empty voting.[328] It occurs when the investor has established negative economic exposure to a corporation's share price, but has retained the right to vote (typically through synthetic instruments). It can also occur where the investor has an interest in the issuer, but a more significant interest in a transaction (such as an acquisition of the issuer) which would benefit from a decrease in the value of the issuer's shares. In either case, the investor will benefit from the value of the issuer's shares going down. When the investor votes, he or she will vote in a way that is counter to the economic best interests of the corporation (although consistent with the investor's interests). The important distinction between empty voting and negative voting for our purposes is that investors very often hold empty votes simply as a result of the mechanics of the share transfer and voting systems or as a result of some unrelated financial transaction (such as share-lending). Negative voting, on the other hand, is

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324 *Ibid*.

325 SEC Concept Release, *supra* note 31 at 31.

326 *Ibid* at 36.

327 *Ibid*.

328 This issue needs to be considered in more depth from an "abuse of the markets" perspective.

typically more purposeful – intended to influence the vote in a manner that is economically beneficial to the shareholder with the negative position.

Hidden voting is often referred to in the discussions relating to empty voting, although the two issues are quite different. Hidden voting refers to a situation in which the investor has the economic exposure, but not the right to vote. It allows the investor to avoid certain disclosure obligations which would alert the marketplace to its interest in the issuer. It is also typically effected through synthetic instruments. This issue has received a great deal of attention as a result of the *CSX* decision.[329] It is relevant here because it raises issues relating to disclosure requirements for interests held through synthetic instruments.

37.1 Empty Voting Through Securities Lending

Empty voting may be effected by borrowing shares immediately prior to a record date and then returning those shares to the lender immediately after the record date (a practice known as "record date capture"). Record date capture also occurs where the record date and the dividend date are set as the same date. Derivative instruments are purchased and held for a very short time – only long enough to realize the dividend income – and then are sold.

37.2 Empty Voting Through Derivative Instruments

Empty voting can also be achieved through the use of derivatives and swap transactions to limit a party's economic exposure to the shares it acquires in order to obtain voting rights without economic exposure. Share-lending is described in the previous section. This section describes the function and operation of derivative instruments and then explores the potential impact of those instruments (and share-lending outside of over-voting) on the proxy voting system.

37.2.1 What Is a Derivative Instrument?

A derivative is a contract, financial instrument or security that derives its value from something else, such as an underlying asset, reference price, interest rate or index. Two of the simplest examples of derivatives are options and futures.

An option is a contract between the buyer (or holder) of the option and the seller (or writer) of the option that gives the buyer of the option the right to buy (or sell) an asset from (to) the seller of the option. The option to buy an asset is known as a call option and the option to sell an asset is known as a put option. Option contracts have a market or premium value and an intrinsic value. The market value is simply the price at which a buyer and seller are willing to enter into an option contract (i.e., the up-front cash premium(s) that the buyer must pay to the seller in order to claim the rights of the particular option contract). The intrinsic value of an option can be

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329 *CSX Corporation v. The Children's Investment Fund Management (UK) LLP et al.*, 562 F. Supp. 2d 511 (SDNY 2008) [*CSX*]. The CSX decision released earlier relates to hidden shares rather than to empty voting. Using the anti-avoidance principles of Rule 13d-3(b) under the *Exchange Act*, the CSX court found that the funds had acquired beneficial ownership of the *CSX* shares through the use of the total return swaps. Accordingly, the funds should have reported their interests in the *CSX* stock over a year before the proxy fight was commenced. (As all the material facts were eventually disclosed, however, the court did not prevent the funds from continuing the proxy battle or voting their shares.)

thought of as the price a rational investor would pay for an option if it were about to mature instantly.

A forward transaction involves a contract under which both the buyer (or holder) of the contract and the seller (or writer) of the contract are obligated to execute a transaction at a pre-specified price on one or more pre-specified dates. In other words, the seller is obligated to deliver a specified asset to the buyer on a specified date in the future and the buyer is obligated to pay the seller a specified price (the forward price) on delivery. The underlying assets of these contracts may include traditional agricultural or physical commodities, currencies (e.g. foreign exchange forwards), interest rates (e.g. forward rate agreements) and equity securities.

Options and futures are the building blocks used to construct more sophisticated financial instruments, including rate swap transactions, swap options, basis swaps, forward rate transactions, commodity swaps, commodity options, equity and equity index swaps, equity and equity index options, bond options, interest rate options, foreign exchange transactions, cap transactions, floor transactions, collar transactions, currency swap transactions, cross-currency rate swap transactions, currency options, credit protection transactions, credit swaps, credit default swaps, credit default options, total return swaps, credit spread transactions, weather index transactions and forward purchases and sales of a security, commodity or other financial instruments. As new trades are engineered and are used more commonly, the list of the types of derivative instruments will continue to evolve.

Derivatives are generally classified as exchange-traded or over-the-counter products. Exchange-traded derivatives are traded over an exchange on standard terms (other than price) and are cleared through a clearing issuer. Examples of exchange-traded derivatives include commodity futures, index futures and various options. Credit risk is minimized or eliminated in the exchange-traded derivatives market because a clearing house settles each trade with market participants. Over-the-counter derivatives, on the other hand, are bilateral contracts with non-standard, privately negotiated terms. One of the key elements of over-the-counter derivatives is the credit terms agreed by the parties to manage the inherent credit exposure to the other party.

37.2.2 How Are Derivative Instruments Used?

Derivatives can be used for speculative and hedging purposes. A hedge is designed to mitigate risk, while speculative investment creates exposure to some anticipated risks. Both hedging and speculating with derivatives products expose counterparties to a number of unanticipated and unquantifiable risks that may not be taken into account or mitigated.

Traditional "plain vanilla" derivatives, used to hedge against currency and interest rate exposure, measure in the trillions of dollars and are entered into by mainstream public and private companies, usually with financial institutions that act as intermediaries. Manufacturers that depend on a particular element in their production, such as precious metals or other commodities, may enter into commodity forwards or other derivative contracts to mitigate against increases in the price of such raw materials. Similarly, producers of agricultural products and other commodities can enter into forward contracts and other derivatives to ensure a minimum price for their production. Many institutional investors, such as pension funds, sovereign funds and

private investment funds also use derivatives to hedge against various risks inherent in their portfolios or with respect to specific investments.

Institutional investors, financial institutions and other participants in the derivatives market may also use these financial instruments to speculate. For example, rather than purchasing a security, an end user could enter into a swap under which it receives the gain on the price of such security and other returns while paying the counterparty for any reduction in the price of such security. Such a transaction is referred to as a total return swap, which has been the subject transaction in respect of a number of empty voting cases. There are speculative investors likely involved in every aspect of the derivatives markets, from weather and commodities to interest and currency rates.

37.3 Examples of Derivative Instruments Used to Influence Shareholder Votes

There is no empirical data on the impact of derivative instruments on shareholder votes. We have described below several scenarios in which derivative instruments were an issue to some degree.

37.3.1 *Sears Canada Inc.*[330]

In 2005, Pershing Square Capital Management LP ("Pershing") entered into total return swaps with a counterparty with respect to the shares of Sears Canada Inc. ("Sears Canada") which had the effect of giving Pershing economic exposure to the performance of Sears Canada's shares without legal ownership. That counterparty hedged its exposure under the total return swaps through back-to-back total return swaps with a Canadian bank. That bank, in turn, hedged its exposure by acquiring shares of Sears Canada. Shortly thereafter, Sears Holdings Corporation ("Sears Holdings") made a take-over bid to acquire all of the outstanding shares of Sears Canada not already owned by it.

Certain Canadian banks who held Sears Canada shares as hedges against total-return swaps would not tender into the bid as they would derive a tax benefit from holding the shares for a longer period of time. To accommodate this longer time horizon, Sears Holdings entered into agreements with these banks whereby the banks agreed to vote in favour of a future second-step transaction that Sears Holdings would propose following the completion of its bid, the effect of which would be to squeeze out all shareholders (including the banks) who did not tender into the bid. Pershing was opposed to the bid and the proposed second-step transaction as it wished to maintain its interest in Sears Canada.

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330 *Sears Canada Inc*. (2006), 22 B.L.R. (4th) 267 (OSC) [*Sears Canada*].

As the banks held their shares as a hedge against total return swaps, which passed through to the swap counterparty the economic interest in the shares, the banks had no traditional economic interest in the transaction on which they would be voting. The banks would, however, derive a tax related benefit if the transaction were to proceed and intended to vote in favour of that transaction notwithstanding that their economic interest bore no commonality of interest to the other shareholders. Ultimately, for reasons unrelated to the empty-voting issue, the Ontario Securities Commission blocked the banks from voting their Sears Canada shares to approve the second-step transaction.

37.3.2 *Mylan and King Pharmaceuticals*

In the United States, the Perry-Mylan Laboratories case[331] is a frequently cited example of empty voting. On July 23, 2004, Mylan Laboratories, Inc. ("Mylan") entered into a plan of merger with King Pharmaceuticals, Inc. ("King"). The stock-for-stock merger required Mylan shareholders' approval. After the announcement, Mylan's shares dropped sharply. As of late 2004, Perry Corporation ("Perry"), a hedge fund, owned 7 million shares of King and if the merger closed, Perry would make a $28 million profit. In order to facilitate the merger's approval, Perry bought a 9.9 percent stake in Mylan, but fully hedged its stake in Mylan by shorting an equal number of Mylan's shares through equity swaps. Perry became Mylan's largest shareholder, having both a significant influence over the merger and a significant interest in the transaction, but with no economic interest in Mylan. It was rumoured that other hedge funds, including Citadel, had followed the same strategy.[332] High River Limited Partnership (the "Plaintiff"), a major Mylan shareholder which opposed the transaction, sued Mylan and Perry under federal securities law. He asserted that Perry and other hedge funds had acquired 19 percent of Mylan's voting shares with no economic exposure to the shares. However, the suit became moot because Mylan abandoned the acquisition due to accounting problems at King.

37.3.3 *Multi-Fineline Electronix*

The case of *Multi-Fineline Electronix*[333] is another example. On March 30, 2006 Multi-Fineline Electronix, Inc., a Delaware company ("M-Flex") offered to purchase all of the outstanding shares of MFS Technology Ltd., a Singapore company ("MFS"). At the time of the offer, WBL Corporation Ltd. ("WBL"), another Singapore company, owned 61 percent of M-Flex's common stock, as well as 56 percent of MFS's common stock. The offer required approval by both the majority of all of M-Flex's shareholders and the majority of M-Flex's minority shareholders. M-Flex set up a special committee in connection with the proposed transaction. Initially, the

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331 See *High River Ltd. P'ship v. Mylan Labs., Inc.*, 353 F. Supp. 2d 487 (M.D. Pa. 2005) [*Perry-Mylan Laboratories*]. See generally, Henry T.C. Hu & Bernard Black, "Hedge Funds, Insiders, and the Decoupling of Economic and Voting Ownership: Empty Voting and Hidden (Morphable) Ownership" (2007) 13 J. Corp. Fin. 343.

332 *Ibid*.

333 See complaint for declaratory and injunctive relief, *Multi-Fineline Electronix, Inc. v. WBL Corp*., 2006 WL 4781677 (Del. Ch. Oct. 17, 2006); order granting defendants' motion to dismiss first amended complaint, *Mutli-Fineline Electronix, Inc. v. Stark Master Fund Ltd*., No. 06-0960 (C.D. Cal. Dec. 4, 2006); and order granting defendants' motion to dismiss plaintiff's complaint, *Multi-Fineline Electronix, Inc. v. WBL Corp*., 2007 WL 2752983 (Del. Ch. Feb. 2, 2007).

special committee had determined that the transaction was in the best interests of M-Flex's shareholders. At the same time, WBL and M-Flex entered into a lock-up agreement in which WBL agreed to vote its M-Flex shares in favour of the acquisition. However, after M-Flex's shares dropped, reflecting the fact that M-Flex's offer was overpriced, M-Flex's special committee withdrew its recommendation in favour of the transaction. Despite the special committee's recommendation against the transaction, WBL reaffirmed its intent to perform its obligations under the lock-up agreement and refused to vote against the acquisition.

In mid-June 2006, Stark Investments ("Stark"), a hedge fund, began to purchase substantial blocks of M-Flex's common shares. By September 29, 2006, Stark had acquired 18.4 percent of M-Flex's shares, or approximately 48 percent of the M-Flex minority shares outstanding. Concurrently, Stark hedged most or all of its interest in M-Flex, reducing or eliminating its economic exposure to M-Flex's shares. Stark also owned 4.9 percent of MFS's shares. Therefore, Stark would make a significant profit through its holdings in MFS if the proposed transaction closed: the more M-Flex would overpay for MFS, the more Stark stood to profit. Stark had a significant interest to vote for the offer even if it was not in the best interest of M-Flex's shareholders. Not only could this be characterized as empty voting in that Stark had no economic interest in M-Flex but it actually had an interest in M-Flex over-paying for MFS.

37.3.4 *MONY Group*

The *MONY Group* case[334] also provides a good illustration of using derivative instruments to acquire voting rights without the corresponding economic exposure to the outcome of the vote. On September 17, 2003, MONY Group, Inc. ("MONY") and AXA executed and publicly announced a merger agreement. The agreement provided for a $31 per share all cash acquisition of MONY by AXA. In order to finance the transaction, AXA issued convertible bonds, which were convertible into AXA shares on completion of the acquisition.

Following the issuance of the convertible bonds, the market price of AXA shares had increased. Therefore, a person who held long positions in AXA bonds would earn a large profit if the MONY acquisition were completed. Consequently, holders of AXA bonds acquired MONY shares in order to vote for the merger. Conversely, short sellers of AXA bonds, which included hedge funds, acquired MONY shares in order to vote against the merger. Both groups hedged their position in MONY but retained the right to vote their shares of MONY.

37.4 Effect of Separating Votes from Economic Interest

As discussed above, equity derivatives can be used to separate the economic interest in a share from the voting rights attached to such share. The separation of such rights can result in "empty voting" where the holder of the right to vote no longer has any economic exposure to the value of the issuer; "negative voting" where the holder of the right to vote has an economic incentive to cause the value of the issuer to decline; and "skewed voting" where the holder of the right to vote does not appear to have the same incentives with respect to the issuer as traditionally attributed to longer-term beneficial holders of shares. The traditional view on the incentive of a beneficial

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334 See *In re MONY Group Inc. Shareholder Litigation*, 853 A.2d 661 (Del. Ch. 2004); *In re MONY Group Inc. Shareholder Litigation*, 852 A.2d 9 (Del. Ch. 2004). See generally, Hu, *supra* note 331.

holder of a security is that such holder will act to maximize share value over the longer term. As discussed in more detail below, it is difficult to assess the impact of skewed voting on the efficacy of the voting process or its outcomes.

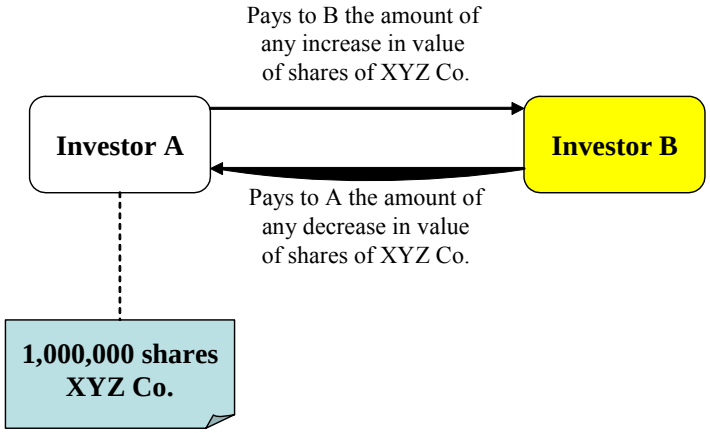
There are numerous examples of equity derivatives that can be used to effect a separation of voting rights from beneficial ownership. Derivative financial instruments, including warrants, options, swaps, convertible securities, notional principal contracts, contracts for difference, forward contracts, futures contracts and options where the underlying or reference asset is a share or other equity interest constitute "equity derivatives". The challenge posed by derivative instruments in the context of the issues raised in this paper are similar to the challenges faced by regulators, legislators and internal and external risk managers; that is, how these instruments can be used to separate voting rights from beneficial ownership is limited only by the imagination and creativity of the sophisticated financial engineers who structure these trades.

Perhaps the simplest example, and the type of transaction considered in both the Sears and CSX decisions,[335] is a total return swap. In a total return swap, one party, A, agrees to pay the other party, B, the increase in the value of the reference shares and B agrees to pay A the decrease in the value of the reference shares. Under such a transaction, B would not own the reference shares but would have similar incentives with respect to the issuer as beneficial long-term holders of such shares. A, on the other hand, may acquire the reference shares to hedge its exposure under the swap including the right to vote such shares, but would be indifferent as to the outcome of any such vote.[336] Such a scenario is referred to as empty voting in that A has the right to vote, but lacks the economic incentive to vote one way or another. Perhaps a more egregious problem that arises from such a transaction is the prospect of negative voting. Consider in this transaction that A owns one million shares of XYZ Company which is about to acquire the issuer of the reference shares. If A believes that such acquisition is good for XYZ Company, A may have an incentive to vote in favour of the acquisition by XYZ Company even if a competitive bidder may pay more for the issuer of the reference shares or if the issuer is better off not approving the acquisition. This example is illustrated in Diagram 5.

335 *Sears Canada*, *supra* note 330.

336 We say that A "may" acquire the referenced shares because A could use options or other methods of hedging its exposure to B under the total return swap.

Diagram 5: Separating Votes from Economic Interest Via Total Return Swap



1. If the value of the shares of XYZ Co. increases, Investor B gets paid the amount of such increase by Investor A. Investor B's interests are therefore aligned with the shareholders of XYZ Co. despite investor B holding no shares in XYZ Co.

2. If the value of the shares of XYZ Co. declines, Investor A gets paid the amount of such decline by Investor B. Accordingly, despite holding shares of XYZ Co. and having the right to vote those shares, Investor A has an incentive to see the shares of XYZ Co. lose value

Results similar to those described above in respect of a total return swap could be achieved by A using a forward contract. Under a forward contract, a party agrees to purchase or sell a reference asset at a set price on some date in the future. Suppose A acquires shares of an issuer and sells them forward at a set price for settlement on a future date. As in the case of a total return swap, A will maintain the right to vote its shares of the issuer, but will not have the same incentives with respect to an increase or decrease in the price as a traditional shareholder. The likely result is that A simply would not vote the shares. If A did vote its shares, it would likely constitute empty voting or, if such transaction was combined with ownership by A of other assets, the value of which could be influenced by voting A's shares of the issuer, it could result in negative voting.

Similarly, the use of put and call options may result in a separation of the voting rights attached to, and beneficial ownership of, a security. If A owns 10 shares and purchases a put option on 10 shares, as in the case of a total return swap, A is protected from downside risk on the shares below the exercise price because A will be able to put the shares to its counterparty at the exercise price regardless of the market price. If A writes (sells) a call option on the shares, it maintains the right to vote the shares but will not benefit from any increase in the share price above the exercise price because the counterparty will exercise its call right if the market price is above the exercise price of the call option. In both of these examples, A maintains voting rights with respect to the shares.

What impact do these transactions have on A's incentive to vote the shares one way or another? Clearly, A does not have the same incentives with respect to the longer-term value of the reference shares as a traditional shareholder. Further, volatility is a principal component of

options pricing. If the volatility in the market for the shares underlying the options held or sold by A changes materially, the value of the options may generate substantial profits or losses. Therefore, the incentives that motivate A's voting may give rise to a "skewed voting" scenario.[337]

Skewed voting may also result in strategic behaviour by a shareholder that is inconsistent with the interests of longer-term traditional shareholders.[338] For example, if A acquired a substantial put position that would allow A to benefit in the short run from a decline in the value of the shares, A may vote for resolutions that would cause the value of shares of the reference issuer to decline. Another example of skewed voting[339] would occur where A owns 10 shares of an issuer and sells 10 call options on those shares. As with puts, A's incentives differ from those of a longer-term shareholder in that A has limited upside so is indifferent as to decisions that would increase the value of shares, at least until the options expire. A would not likely favour proposals that would increase the value of shares (because A's counterparty would exercise its call and acquire the shares at the exercise price) and may oppose proposals that would incur a non-zero risk of a decline in the stock price in order to obtain a larger risk-adjusted increase in value. Similar issues arise if A sells puts and buys call options on the underlying shares. In the latter case, in certain circumstances, A may be more risk-seeking with respect to gains than a typical shareholder to gain from volatility-enhancing resolutions, thereby increasing the value of its calls, even if this enhanced volatility greatly diminishes the value of the reference shares.

37.5 U.S. Case Law

U.S. courts have considered the decoupling of economic interest and voting power through the common law prohibition on "vote buying."[340] From a public policy standpoint, vote buying was perceived to infringe on each stockholder's right to rely upon the independent judgment of fellow stockholders.[341] Defined as "a voting agreement supported by consideration personal to the stockholder, whereby the stockholder divorces his discretionary voting power and votes as directed by the offeror", vote buying has been privy to greater tolerance since the decision of the Delaware Court of Chancery in *Schreiber v. Carney*.[342]

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337 See e.g. Shaun Martin & Frank Partnoy, "Encumbered Shares" (2005) 3 U. Ill. L. Rev. 775 for a more in-depth analysis of the influence of entering into put and call options on shareholder voting.

338 What (if anything) can or should be done about these phenomena raises bigger issues about the purpose and scope of effective regulation of securities markets.

339 See s. 46.2.

340 Henry T.C. Hu & Bernard Black, "*Equity and Debt Decoupling and Empty Voting II: Importance and Extensions*" (2007) 156 U. Pa. L. Rev. 625 at 640 citing e.g. *Chew v. Inverness Mgmt. Corp.*, 352 A.2d 426 (Del. Ch., 1976).

341 *Schreiber v. Carney*, 447 A.2d. 17 (Del. Ch., 1982) at 24 [*Schreiber*].

342 *Ibid* at 23.

37.5.1 *Schreiber v. Carney*[343]

In the leading case on vote buying, Vice Chancellor Hartnett found vote buying permissible provided it satisfies a test of "intrinsic fairness" pursuant to an examination of the buying arrangement's object or purpose.[344]

In that case, the plaintiff brought suit by way of a derivative action, challenging the propriety of a loan between the defendant, Texas International Airlines Inc. ("TIA") and Jet Capital Corporation ("Jet Capital"), the holder of 35 percent of the shares of TIA. The share structure of TIA effectively provided Jet Capital with the power to block a merger requiring shareholder approval. In the face of an intolerable tax burden, Jet Capital announced its intention to vote against the transaction. TIA and Jet Capital then reached an agreement pursuant to which TIA provided Jet Capital a loan and Jet Capital agreed to vote.

The Court found this to be a clear case of vote buying and held that "under our present law, an agreement involving the transfer of stock voting rights without the transfer of ownership is not necessarily illegal and each arrangement must be examined in light of its object or purpose."[345] The court then set out a two-part test:

- voting agreements "should not be considered to be illegal *per se* unless the object or purpose is to defraud or in some way disenfranchise the other stockholders;"[346]and
- in light of its susceptibility to abuse, vote buying is a voidable transaction "subject to a test for intrinsic fairness."[347]

As the agreement's object and purpose was not to defraud or disenfranchise other stockholders, but to further the interest of all TIA stockholders, the agreement was not found *per se* illegal.[348] Having been ratified by a majority of the independent stockholders after full disclosure, the agreement passed the intrinsic fairness test.[349]

37.5.2 *Crown EMAK Partners, LLC v. Kurz*[350]

Schreiber was recently upheld by Justice Holland of the Supreme Court of Delaware in *Crown EMAK Partners.* Kurz, an incumbent director of EMAK, supported an initiative by the plaintiffs, Take Back EMAK, LLC ("TBE"), to establish a new board majority by delivering consents. In

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343 *Ibid.*

344 *Ibid.* at 26.

345 *Ibid.* at 25.

346 *Ibid.* at 25.

347 *Ibid.* at 26.

348 *Ibid.* at 26.

349 *Ibid.* at 26.

350 *Crown EMAK Partners, LLC v. Kurz*, 992 A. 2d 377 (Sup. Ct. Del., 2010) [*Crown EMAK*] rev'ing in part *Kurz v. Holbrook*, 2010 Del. Ch. LEXIS 24 (Del. Ch., 2010) [*Kurz*].

order to take control of the board, Kurz acquired the economic and voting rights in 150,000 shares of restricted stock from a former employee of the company. He did not, however, acquire legal title to the stock.

Affirming the Court of Chancery's decision, Justice Holland did not find the share purchase to constitute improper vote buying.[351] The agreement, delivering swing votes, was disenfranchising and therefore merited judicial review.[352] The court was particularly concerned with the extent to which vote buying "compromises the ability of voting to perform its assigned role" by creating a "disconnect between voting rights and the economic interests of shares."[353] A study conducted by Robert Thompson and Paul Edelman was cited for the proposition that "[a] decision making [sic] system that relies on votes to determine the decision of the group necessarily requires that the voters' interest be aligned with the collective interest."[354] As such, it is imperative to ensure alignment between share voting and the financial interest of the shares.[355] Quoting Vice-Chanceller (now Chief Justice) Steele, Justice Holland summarized:[356]

> [G]enerally speaking, courts closely scrutinize vote-buying because a shareholder who divorces property interest from voting interest fails to serve the "community of interest" among all shareholders, since the "bought" shareholder votes may not reflect rational, economic self-interest arguably common to all shareholders.

Put another way, the legitimacy of a stockholder vote is derived from the "premise that stockholders with economic ownership are expressing their collective view as to whether a particular course of action serves the corporate goal of stockholder wealth maximization."[357]

The court's expressed disquiet with the separation of voting and economic interests was not essential to their judgment. As described, Kurz obtained both the economic and voting rights in the shares under the terms of the agreement. For that reason, the court's pronouncements on the separation of interests should be taken as *obiter*.

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351 *Crown EMAK, ibid.* at 4. Justice Holland did, however, reverse the lower court's judgment, holding that the transaction amounted to an improper transfer that was prohibited by share restrictions.

352 *Ibid.* at 25.

353 *Ibid.* at 26, citing Robert Thompson & Paul Edelman, "Corporate Voting", (2009) 62 Vand. L. Rev. 129 at 143.

354 *Ibid*. at 27, citing Thompson *ibid*. at 174.

355 *Ibid.*

356 *Ibid*. at 27 citing *In re IXC Commc's, Inc. S'holders Litig*., 1999 Del. Ch. LEXIS 210 at 8 (Del. Ch. 1999).

357 *Ibid.* at 28.

37.5.3 *Parfi Holding AB v. Mirror Image Internet, Inc*.[358]

In *Parfi Holding* the court found that continuous ownership, a condition for bringing a derivative action, may be breached in instances where one's economic interest is divested.[359] The plaintiff in this case, having brought a derivative action on behalf of the company, sold off his economic interest, becoming an empty holder, and therefore lacked standing.[360]

In the court's opinion, to have allowed otherwise would have invited abuse of the representative litigation mechanism, thereby undermining its credibility and utility in enforcing "high standards of fiduciary conduct."[361] The divestiture of economic interest amounted to a breach of the continuous ownership rule, the purpose of which is to ensure a plaintiff prosecuting a derivative action has an economic interest aligned with that of the corporation.[362] Succinctly, in the case of an empty plaintiff, form does not trump substance; that is, ownership of shares does not trump a "lack of any economic interest whatsoever in the interest pursued for the corporation."[363]

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358 *Parfi Holding AB v. Mirror Image Internet, Inc.*, 954 A.2d 911, 2008 Del. Ch. LEXIS 124 (Del. Ch., 2008) [*Parfi Holding*].

359 *Ibid.* at 915.

360 *Ibid.*

361 *Ibid*.

362 *Ibid* at 937 and 939.

363 *Ibid* at 940.

PART VIII – SOME THRESHOLD ISSUES TO ADDRESS

We have written this paper to provide a common base of understanding in the Canadian capital markets community about how the proxy voting system operates. Our hope is that this will allow interested parties to identify and prioritize problems that compromise the effectiveness of the system. The objective is to establish confidence in the quality of the shareholder vote in Canada.

As a result of researching and writing this paper, we have enhanced our own understanding of the system and the challenges that jeopardize its effectiveness. We believe it is important to do more than just describe the problem. At the same time, we think it will be most helpful to offer more than aspirational goals.

Accordingly, we have set out a number of specific threshold issues which we believe must be addressed before definitive steps can be taken to improve the quality of the shareholder vote in Canada. These threshold issues do not represent a complete catalogue of issues or a comprehensive set of solutions. We do, however, believe that addressing these issues can be a first step in moving towards an effective proxy voting system in Canada.

38 Availability of Information

In this section we discuss the key issues relating to the availability of information about the proxy voting system.

38.1 Lack of Access to the Information Necessary to Assess the System

A universe of information exists that would allow a person or group with a public policy mandate to conduct a thorough review of the proxy voting system. Every issuer and investor could, of course, provide information about their own experience, but they can only report on the individual issues they have encountered. Some of the problems reflected in these experiences may be isolated, others may be part of systemic weaknesses or deficiencies. The information needed to evaluate the system resides in aggregated form to varying degrees with CDS, the intermediaries, Broadridge, the transfer agents, the proxy advisors and the proxy solicitors. A thorough examination of the system would require unrestricted access to the systems and processes which these organizations use as well as the data generated by their systems and processes.

What are the barriers to accessing this information?

First, some of these organizations have no legal obligation to provide information to a third party. Those organizations who are obliged to respond to the inquiries of a regulator are currently not being required to provide the type of information necessary for a comprehensive evaluation of the system.

Second, while most of these organizations are highly responsive (in our experience) to inquiries about the system, there is likely information about their business that they would prefer not to provide for any one of a number of reasons.

Third, each organization maintains information in its own form for its own purpose. Notwithstanding the electronic interface which certain participants in the system have with certain other participants, it may be challenging to try to connect the various pieces in hopes of seeing how the system works from beginning to end. Many of these organizations audit their systems (whether for themselves or to report to clients), but there is no process by which the system as a whole is audited in order to provide assurance to the marketplace that investors have an appropriate opportunity to vote and that their votes are given their full weight at the meeting in question. Whether all of the various systems could be made to interface effectively for this purpose seems likely, but is as yet untested.

Finally, each of the organizations involved has an economic interest in the way in which the system currently operates. They will also have an economic interest in any change made to the system. Changes can either create opportunities for a service provider or can impose additional costs. It is therefore not unreasonable to assume that the information that they release about the system is selected and presented in a way that best protects their business interests. Accordingly, anyone involved in a review of the system must understand that it is dependent for its information and analysis on parties with a commercial interest in that system that may or may not be aligned with the interests of issuers and investors.

38.2 Lack of Information Prevents Regulatory Oversight

Securities regulatory authorities currently do not oversee the effectiveness of the proxy voting system as a whole, nor do they monitor compliance with the aspects of the proxy voting system that are regulated. It may be that they cannot play a larger role in the proxy voting system because they lack the resources necessary to do so.

A number of changes would be needed in order for securities regulators to be able to oversee the proxy voting system or, at least, to monitor compliance with securities regulations. For example, they would need to acquire the expertise necessary to be able to develop and maintain a compliance program. In addition, they would need to be able to compel disclosure from each of the relevant participants in the proxy voting system. They are not currently in a position to compel disclosure from certain key participants, particularly proxy agents.

38.3 Lack of Incentive to Share Information Among Providers is a Barrier to Solutions

The fact that information about the system is housed with organizations that compete with one another can create barriers to developing solutions. For example, Broadridge and the transfer agents compete in certain parts of the system with each other (both offer mailing and tabulation services for NOBOs). At the same time, since Broadridge is responsible for almost all of the OBO mailings and tabulations - and transfer agents are responsible for almost all of the registered shareholder mailings, official tabulation and scrutineering functions - Broadridge and a transfer agent are typically both engaged with respect to any individual shareholder meeting and would need to share information in order to provide end-to-end vote confirmation.

The SEC Concept Release raises this issue as a possible obstacle to providing vote confirmation to investors. It notes that "…[a] number of market participants contend that some proxy service providers, transfer agents, or vote tabulators are unwilling or unable to share voting information

with each other or with investors and securities intermediaries. There are currently no legal or regulatory requirements that compel these entities to share information with each other in order to allow for vote confirmations".[364]

38.3.1 Lack of Information Leads to Lack of Confidence and Engagement

We have described in this paper certain examples of the proxy voting system failing and certain aspects of the system that create a reasonable apprehension and scepticism about the effectiveness of the proxy voting system. Whether this scepticism is well founded is a different question, but it exists. In our view, that scepticism is pervasive enough to merit an independent review of the system. Any such review should identify problems where they in fact exist, or assure the marketplace that the proxy voting system is already reliable within an acceptable range of tolerance.

In view of the scepticism that exists, it is remarkable that there has been no general call to action for the situation to be rectified. We suspect that this is largely because those who have some concern cannot prove or quantify their concern or because they believe that the scope of the problem is so vast that there is little hope that it will ever be solved. Better information about the reliability would encourage those with the greatest interest in the system – namely issuers and investors – to become engaged in this issue.

38.3.2 What Should Be Done

A first step in being able to conduct a comprehensive review of the operation of the proxy voting system is for all of the participants in that system to be subject to common oversight. Securities regulatory authorities are the most logical body to assume this oversight responsibility where they do not already have it. Accordingly, a first step in amassing and understanding the information necessary to understand where there are problems within the proxy voting system is to bring proxy agents (such as Broadridge) into the securities regulatory framework.

Once the securities regulators have authority over all of the significant participants in the proxy voting system, an information gathering exercise should be initiated by securities regulatory authorities. The scope and methodology should be determined by securities regulatory authorities and informed by the views of those who are knowledgeable about the proxy voting process. The review itself could be carried out by a task force comprised in large part at least of members of the private sector. No one with an economic interest in the operation of the system should serve on the task force, but they will of course be instrumental to the work of the task force. The objective should be to develop a clear understanding of the effectiveness of the system and the major issues that need to be investigated further.

364 SEC Concept Release, *supra* note 31 at 39.

39 Challenges in Moving Away from a Paper-Based System

39.1 Current Status

Many of the problems and inefficiencies in the system are attributable to the fact that it is required to accommodate paper delivery of proxy materials as well as voting instructions and proxies. The technology now exists for virtually all aspects of the voting process to be handled online. It would be less expensive for issuers, more convenient for many investors – and certainly more environmentally friendly – for everything to be done electronically.

At this point in time, however, we remain caught between a paper-based and a paperless world. Broadridge reports that only 13 percent of the issuers take advantage of email delivery to beneficial holders.[365] While a significant percentage of OBOs vote electronically, several of the transfer agents have advised that the vast majority of registered shareholders and NOBOs to whom they mail, use a paper-based form of proxy.

39.2 Role for the Regulators in Encouraging More Widespread Adoption

Canadian law permits electronic delivery in most cases, but regulators have done little to facilitate or incentivize the marketplace to adopt electronic means of communication. The focus is on those (primarily retail) investors for whom electronic communication could be a barrier to being informed and to voting. Some investors might not be comfortable with computers, might not use email or might not be able to retrieve information from a website. Even where this is not the case, some investors may not have the equipment to print large volumes of paper, in particular when the investor has shares of a number of issuers in its portfolio.

Proposed amendments to securities law, discussed at Section 26.3, indicate that this attitude may be changing, but at the present time, neither the legislators (in respect of the corporate statutes) nor the securities regulators are prepared to require investors to deal exclusively with electronic delivery. Issuers and intermediaries are permitted to effect electronic delivery of proxy materials, but only with the written consent of the investor. They must, in any event, still make paper-copy materials available to those who wish to receive the materials that way.

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[365] We note that most corporate statutes allow for electronic delivery, although the *Bank Act*, S.C. 1991, c. 46 is silent on the issue. Accordingly, banks, which represent 12% of all issued Canadian securities, do not have legislative support for e-delivery. Although amendments to the *Bank Act* have been proposed which would allow banks to communicate electronically with their shareholders, those amendments have not yet been proclaimed in force.

It may also be that the lack of adoption rests with the issuers and not the investors since Canadian investors do not seem adverse to using technology. For example, a recent study showed that Canada ranked number one in adoption of online banking, both in terms of number of users and frequency of use. [366]

40 Revisiting the Commitment to OBO Status

40.1 The Canadian Scenario

Non-registered investors first acquired the right to remain anonymous from the issuers in which they had invested in 1987, when NP 41 came into force. Initially, investors could elect to consent to the disclosure of their name, address and security holdings to the issuer in question. If they failed to indicate whether they consented or not, they were deemed to have consented. Today, an investor must designate itself as an OBO or a NOBO before an intermediary may open an account for that investor.

There may be a variety of reasons why an investor prefers to remain anonymous. Some are concerned that they will receive too many unsolicited communications from the issuer. Others are concerned that their trading patterns will be discernable.[367] the IIAC is a strong advocate for shareholder privacy. It must be noted that its members also have an interest in maintaining control over their client lists, an interest that is best protected when its clients are OBOs. In a 2008 letter to the CSA, the IIAC argued that securityholders should be entitled to choose how their personal information is used and disseminated and that once they have made an informed choice, that choice should be respected and protected by every party in the shareholder communication process.[368] Broadridge is also a strong advocate for maintaining an investor's right to opt for OBO status. Broadridge also has a business interest in the status quo since almost all of the intermediaries in Canada outsource OBO communications and OBO vote tabulations to them.

Given the layer of complexity that the OBO concept adds – and the transparency that it reduces – it is worth reconsidering how the concept developed and whether there are other alternatives.

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366 In 2008, comScore, Inc., a leader in measuring the digital world, released a report on the Canadian online banking sector showing that Canada was, at that time, one of the world's most developed markets for online banking. The comScore press release stated that, "Canadians are typically very savvy Internet users, a fact that is underscored by their heavy usage of online banking". Of the 37 global markets individually reported by comScore, Canada ranked number one in adoption of online banking, both in terms of number of users (67.1% of Canadian Internet users banking online in the measurement period, while other English-speaking countries had significantly fewer online banking users, including the U.K. (49.5%), the U.S. (44.4%), and Australia (41.7%)) and also in terms of frequency of use, where Canadians also led the world. comScore has in the past also reported that Canadian Internet users lead the world in online video viewing, access to Internet humour sites and use of search engines. See comScore, "Canada leads world in online banking usage" (10 July 2008), online: <http://www.comscore.com/Press_Events/Press_Releases/2008/07/Canada_Online_Banking>.

367 This concern has been raised by the CCGG, for example. See Broadridge presentation.

368 Broadridge presentation at 7.

40.2 OBO Status in the United States

40.2.1 Introduction of OBO Status in the United States

The OBO/NOBO regime was adopted in the United States in January 1986, based on the recommendations of the SEC Advisory Committee on Shareholder Communications.[369] As was the case in Canada, U.S. regulatory authorities recognized that they needed to fix the broken communication chain between the issuer and its investors and that the intermediaries would have to play a role in any solution. It is interesting to revisit some of the arguments against the systems that were ultimately adopted.

The issue of identifying shareholders to the issuers generated the most intense debate and deliberation by the Committee.[370] Approximately 130 commentators supported the idea of shareholder identification and direct communication, while 60 commentators were opposed.[371]

The Committee ultimately recommended a compromise – shareholder identification, but only for those who consented:

> The Committee finds that there is a very substantial interest on the part of issuers and others in creating a means [to] identify beneficial owners and communicate directly with them. …At the same time, the Committee finds that there remain substantial questions about the workability and cost of direct communication in connection with proxy distribution. Therefore, the Committee has concluded to recommend that a system be adopted whereby issuers will have access to the names, addresses and shareholdings of their beneficial shareholders whose stock is held by broker-dealers and who consent to the release of such information to the issuer.[372]

40.2.2 Current Arguments in the United States for Eliminating the OBO/NOBO Distinction

The OBO/NOBO system in the United States is similar to the Canadian system.[373] A 2006 study conducted for the NYSE Group raised questions about whether retail investors understand the

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369 U.S. Securities and Exchange Commission, "Improving Communications Between Issuers and Beneficial Owners of Nominee Held Securities", Report of the Advisory Committee on Shareholder Communications [1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,224 (June 1982) at ¶ 85,171 [Advisory Committee Report].

370 *Ibid*. at ¶ 85,171

371 *Ibid*. at ¶ 85,172 fn 92.

372 *Ibid*. at ¶ 85,171.

373 It is, however, not identical. For example, in Canada, the issuer may send proxy materials to its NOBOs directly. In the United States, the mailing must be done through the intermediaries.

OBO/NOBO distinction.[374] Nearly half (44 percent) of respondents were not sure if most of their accounts were OBO or NOBO.[375] However, once given a comprehensive explanation of the difference between OBO and NOBO status, respondents said they would opt to be NOBOs by a 2-1 margin (64 percent NOBO versus 36 percent OBO). The preference for being an OBO changed radically if there was a fee associated with it. Only 14 percent of respondents said they would prefer to be OBOs if there was a $25 fee associated with that choice – only five percent would still opt to be OBOs with a $50 annual fee.[376]

A recent U.S. report[377] prepared for the Council of Institutional Investors by Alan L. Beller and Janet L. Fisher of Cleary Gottlieb Steen & Hamilton LLP considered the OBO/NOBO distinction. It concluded that the interest of shareowners and companies in better communication would be more effectively served by less reliance on – or the elimination of – the OBO/NOBO distinction.[378] It proposed a process through which this could be effected. First, brokers would be required to make NOBO the default status for customer accounts (as was the case in Canada under NP 41), with full disclosure about the consequences of selecting OBO status. A charge would then be imposed on OBOs to defray the costs of maintaining a platform to support OBO status. The theory is that this step would ultimately lead to the elimination of the OBO/NOBO distinction, with customers able to preserve their anonymity through nominee accounts at their own expense. After that, the report recommends that restrictions be relaxed on the ability of companies and shareholders to distribute proxy materials and solicit proxies directly, and streamline the process for both companies and shareowners to obtain shareowner lists.

This report also discusses the reforms necessary to achieve reliable end-to-end audit trails, such as the cascading series of executed proxies to the beneficial owner.[379]

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374 Opinion Research Corp., *Investor Attitudes Study: conducted for NYSE Group* (7 April 2006), online: <http://www.nyse.com/pdfs/Final_ORC_Survey.pdf> [Investor Attitudes Study]. Broadridge suggests that the form of the questions posed in this study have produced results that do not accurately reflect investor preference.

375 37% of respondents thought most of their accounts were NOBO, while 18% thought most of their accounts were OBO.

376 Investor Attitudes Study, *supra* note 374.

377 CII Report, *supra* note 66.

378 *Ibid*. at 20. The report goes on to note as follows: "A more ambitious goal to ensure not only improved communications, but also more reliable voting seems difficult to achieve without a more radical solution that is (or approaches) a pure direct communications framework with cascading executed proxies. Implementing such an approach would, however, almost certainly be more contentious, since it would implicate complex strategic, cost, logistical and other considerations of critical importance to key participants."

379 In the SEC Concept Release, *supra* note 31 at 64-77, the SEC expressly seeks comment on whether the OBO/NOBO distinction should be eliminated. Another alternative put forward for consideration is shifting the cost of distributing proxy materials to broker-dealers for customers who elect to be OBOs.

40.3 Other Jurisdictions

Canada is the only country, other than the United States, to have adopted the U.S. OBO/NOBO regime. Other jurisdictions permit issuers to directly communicate with all of their investors. For example, in the United Kingdom and Australia, issuers may trace beneficial ownership of their shares through a written notice process.[380] Australia also requires issuers to keep a registry with the names and addresses of all of its shareholders, including beneficial owners.[381] It protects investor privacy by forbidding disclosure of identity and address information on matters unrelated to the interests or rights of shareholders in the affairs of the issuer.[382]

40.4 Regulatory Bias That Penalizes NOBOs

It appears to us that a regulatory bias has developed in Canada against treating NOBOs and OBOs differently. The objectives of the securities regulators have remained consistent. They first articulate their objective as ensuring "…that non-registered holders have the same access to corporate information and voting rights as registered holders."[383] Then, they acknowledge that one of the fundamental principles was that "…all securityholders of a reporting issuer, whether registered holders or beneficial owners, should have the opportunity to be treated alike as far as is practicable."[384] The Proposed Amendments seek in several ways to limit the extent to which the treatment of NOBOs can mirror the treatment of registered shareholders for fear that the NOBOs will enjoy some status or right that is unavailable to the OBOs. In doing this, the CSA is penalizing the NOBOs for a choice (the choice of anonymity) that they did not make.

40.5 Revisiting the Merits of the OBO Solution

Whatever the merits of giving investors the right to adopt OBO status, it seems clear to us that this entitlement does introduce some additional complexities into the system. Moreover, OBO status is not the only way for the privacy needs of an investor to be addressed. Confidential voting has been an option for many years as a means of preventing an issuer from knowing how a particular shareholder or investor voted. Investors who do not wish to have their trading patterns revealed could hold their shares through nominee entities.[385] To address the concern of retail investors, in particular that they do not wish to be called by the issuer or its proxy solicitation agents, securities regulations could prohibit issuers and their agents from doing so if the investor has indicated that it does not wish to receive such calls in the same way that an

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380 *Companies Act 2006* (U.K.), 2006, c. 46, s. 793; *Corporations Act* 2001 (Cth), s. 672A.

381 Corporations Act 2001 at ss. 169, 672DA.

382 *Ibid*. at s. 177. See also *Tracing Beneficial Ownership*, Australian Securities & Investments Commission Regulatory Guide 86, (26 June 2007).

383 *Shareholder Communication*, O.S.C. NP 41, (1987) 10 O.S.C.B. 6307 (28 October 1987) at Part I.

384 NI 54-101.

385 In other jurisdictions, such as Australia, where the anonymity of the Canadian system does not exist, we are not aware of there being any concerns with institutional investors' trading patterns being compromised or intermediaries losing clients as a result of issuers knowing who their clients are. In the United States, the SEC is currently considering whether to maintain the OBO/NOBO distinction. See SEC Concept Release, *supra* note 31 at 73.

investor can elect not to receive certain documents. To address institutional investors' concerns that their trading patterns may be discernable, disclosure to issuers could be restricted to record date lists. There are undoubtedly flaws in these suggestions as there are in the OBO model, but in our view it is important that we assess the OBO model objectively, rather than simply assuming that it is the only way to address the legitimate concerns of investors who currently enjoy this status.

41 Problems Created by Intermediary Files That Are Not Reconciled for the Purpose of Proxy Voting

41.1 How the Problems Arise

The recordkeeping practices of many intermediaries give rise to problems that result in double voting, over-voting and pro-rated or discarded voting instructions. Some examples of these practices and why they create issues are set out below. This is not an exhaustive list of all of the issues that have been described to us,[386] but the examples described appear to us to be the most consistent sources of problems.

We have no way of knowing how extensive or significant these issues are. However, the impact of these practices on an episodic basis has been described to us by participants in the proxy voting system in Canada and are reflected in some of the situations that have become public through reported case law. The IIAC advises us that anecdotal evidence from its members indicates that where voting problems arise, they are generally caught and rectified.

[386] Another example results from registered shareholders leaving their share certificates with their brokers or other custodian for safekeeping. This creates a risk of double counting because the broker may show that registered shareholder's shares as part of its overall position, with the result that the registered shareholder will both receive proxy materials and a proxy from the transfer agent and will receive a VIF as a non-registered investor. As a result, that person could have the opportunity to vote the same position twice. This can only be avoided if the intermediaries code their files in such a way that this person will not appear on the list of investors generated in connection with a shareholder meeting.

The recent SEC Concept Release reflects a concern with reports of over-voting but notes that (as is the case in Canada), there is little empirical data.[387] The NYSE has also focused on this issue in the past, fining certain broker-dealers for failing to take action to address the potential for over-voting. Between February 2006 and March 2007 the NYSE imposed fines ranging from $250,000 to $1,000,000 against various broker-dealers for numerous over-voting violations.[388] Following the imposition of one such fine, the chief of enforcement for NYSE Regulation commented that "proxy over-voting creates a serious risk that shareholders' votes will not be counted" and that "shareholders are entitled to expect that even in routine matters, the proxy process has been properly supervised by their broker-dealer."[389]

41.2 Examples of Situations That Give Rise to Account Imbalances

41.2.1 Securities Lending Programs

While others do not, some intermediaries who engage in securities lending programs[390] may associate the portion of their position which they have loaned out with the position held on behalf of any particular client.[391] Where they do not, when a record date occurs, all of the intermediary's clients will appear on the beneficial list (as will their own proprietary position) and will therefore be provided with a voting instruction form. The investor who borrowed the shares will also appear on the beneficial list of its intermediary and so will also receive a voting instruction form for the same shares. Accordingly, a single position could then be voted twice (known as double voting) or even more than twice (known as multiple voting), where a series of securities loans have occurred with respect to the same share. Double and multiple voting of loaned shares will often not be apparent. Where it is discovered (for example, where an intermediary's voting instructions exceed its total position), votes may be pro-rated or discarded altogether.

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387 SEC Concept Release, *supra* note 31 at 36:

> Given the lack of empirical data on whether over-voting or under-voting is occurring and if so, to what extent, we also would like to receive views on whether investors, issuers, and the proxy system overall would benefit from having additional data from proxy participants regarding over-voting and under-voting to determine whether further regulatory action should be considered. This data would allow us to determine the scope of the problem, if any, and give us detailed information that would further assist us in determining whether current regulations are effective or additional regulation is appropriate. Such information may also indicate if one particular method is working better for investors and the market than other methods.

388 These violations included failing to timely reconcile stock records on beneficial ownership in connection with proxy voting, keeping inadequate or inaccurate record and transmitting inaccurate information to proxy service providers that resulted in over-voting.

389 See NYSE, "NYSE regulation fines Deutsche Bank Securities $1 million for failure to supervise handling of customer proxies" (15 February 2006), online: <http://www.nyse.com/press/1139915694987.html>.

390 Securities lending programs are described in more detail in Section 37.1 of this paper.

391 Some intermediaries who engage in securities lending have a process whereby an omnibus proxy is claimed and obtained from the broker to whom the securities were delivered.

41.2.2 Not Coding Recordkeeping Accounts to Be Delivered by Non-Clearing Intermediaries[392]

Another example is "non-clearing intermediaries" who use either sub-custodians or Broadridge to distribute voting instruction forms to their underlying clients. Voting instructions from such holders are submitted directly to the transfer agent or to Broadridge for tabulation and therefore are voted under the non-clearing broker's name. When the transfer agent receives voting instructions directly from an intermediary or Broadridge, it can only vote them if it is in possession of an omnibus proxy from the proximate intermediary or other intermediary that the non-clearing intermediary uses for such purposes. Where the proximate intermediary does not provide an omnibus proxy, two things can happen. First, if the transfer agent can identify the proximate intermediary in question, it will seek to obtain a "mini-omnibus proxy" from it, entitling the non-clearing intermediary to vote the positions of their clients. Alternatively, where this is not possible, the proxies may simply be disregarded.

41.2.3 Failed Trades

Notwithstanding that a trade has failed, the intermediary who sought to purchase the securities on behalf of its client may credit its client's account with the purchased securities on the settlement date, a practice known as "contractual settlement." It is generally offered by custodians. If the trade has not settled prior to the record date, then the purported purchaser of the securities will receive proxy materials and a request for voting instructions, as will the seller; however some custodians exclude "contractual settlement" trades for sales from their records. As a result, the votes associated with the position can be cast twice. Some intermediaries have a process whereby an omnibus proxy is claimed and obtained from the broker who failed the trade.

The SEC Concept Release also identifies failed trades as a source of imbalances between the number of shares for which intermediaries submit votes and their total position with DTC.

We have been advised by the IIAC that, just as a position is credited to the buyer's account regardless of whether the trade is settled, the seller's position is debited regardless of whether the trade is settled.

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[392] See Section 27.2.3.

41.3 Regulatory Response

Canadian securities regulators have done very little to address over-voting, although they have acknowledged it as an issue. The Notice of Proposed National Instrument 54-101[393] stated as follows:

> The CSA noted the over-voting problem, particularly in the context of securities lending; the CSA did not take a position in Draft Amended NP 41 on whether a lender or borrower should vote loaned securities; the CSA did recommend, however, that all parties strive to ensure that proxies or voting instructions not be issued for more than the total number of shares registered on the record date and evidenced by any omnibus proxy.

There are two points to note here. First, the CSA was not addressing the issue of the vote being cast more than once (described as "double-voting") in this paper, but only the issue of an intermediary submitting a number of votes that exceeds its total position (over-voting). Second, the CSA has not been prepared to require intermediaries to reconcile their records to prepare over-voting. It has recognized the problem, but has only ever been prepared to address it through the following provision in the Companion Policy to NI 54-101:

> 4.3 Reconciliation of Positions
>
> (1) The records of an intermediary must show which of its clients are NOBOs, OBOs or other intermediaries, and specify the holdings of each of those clients.
>
> (2) In order that the Instrument work properly, it is important that the records of an intermediary be accurate. Its records must reconcile accurately with the records of the person or company through whom the intermediary itself holds the securities, which could either be another intermediary or a depository, or the security register of the relevant issuer, if the intermediary is a registered securityholder. This reconciliation must include securities held both directly and through nominees.
>
> (3) A proximate intermediary should provide accurate responses to requests for beneficial ownership information. Information about the holdings of NOBOs, when added to the holdings of OBOs, the holdings of other intermediaries holding through the proximate intermediary and the holdings that the proximate intermediary holds as principal, must not exceed the total security holdings of the proximate intermediary, including its nominees, as shown on the register of the issuer or in the records of the depository.
>
> (4) It is important as well that the total number of votes cast at a meeting by an intermediary or persons or companies holding through an intermediary not exceed the number of votes for which the intermediary itself is a proxyholder.

393 *Supra* note 215.

The Companion Policy does not have the force of law. If the same language were included in NI 54-101, it would have the force of law and compliance could be enforced by the CSA.

41.4 How Intermediary Accounts Could Be Reconciled

The issues described above can often be resolved if they are caught before record date lists are prepared. The problem is that intermediaries often do not submit the votes associated with their positions until the last couple of days before the meeting because they too are aggregating their positions before they submit them. It is reasonable to ask why the system should depend on problems being corrected, rather than on the problems being prevented.

The problems could largely be prevented if intermediaries made changes to their records as they are used in the proxy voting system. There is no requirement in Canada or in the United States for intermediaries to reconcile the records they keep for their own purposes on a record date to ensure that double voting and over-voting do not occur.[394] The SEC Concept Release describes several reconciliation methods used in the United States to "allocate" votes among customer accounts.[395]

Unless intermediaries provide files to Broadridge which are reconciled or are coded to identify those positions which should not be voted, double or multiple voting and over-voting will continue to occur, requiring some votes to be pro-rated or discarded in order to allow the total votes to be reconciled. In our view, three steps must be taken. First, the problem must be studied in order to determine how significant it is. Second, assuming the size of the problem merits that some action be taken, a reconciliation protocol must be adopted by or imposed on intermediaries to ensure that recordkeeping practices do not lead to double voting, multiple voting or over-voting. Better information about the extent of the problem in Canada and the benefit of the work being done in the United States by the SEC may surface other solutions to address serious issues or to eliminate what seems to be a widely held concern if the conclusion can be reached that no problem exists.

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394 The SEC Concept Release, *supra* note 31 at 31, addresses the fact that there is no regulatory requirement for intermediaries to reconcile their accounts:

> Because the ownership of individual shares held beneficially is not tracked in the U.S. clearance and settlement system, when imbalances occur, broker-dealers must decide which of their customers will be permitted to vote and how many shares each customer will be permitted to vote. Neither our rules nor SRO rules currently mandate that a reconciliation be performed, or the use of a particular reconciliation or allocation methodology. Broker-dealers have developed a number of different approaches as to how votes are "allocated" among customer accounts. We understand that these approaches are often influenced by whether the broker-dealers' customers are primarily retail or institutional investors.

395 The SEC Concept Release, *supra* note 31 at 31-35, describes the primary reconciliation methods as: (i) pre-mailing reconciliation; (ii) post-mailing reconciliation; (iii) a hybrid form of the pre-reconciliation and post-reconciliation methods, and notes that the choice of method is influenced by whether the intermediary's customers are primarily retail or institutional investors.

Broadridge has developed a solution to alert intermediaries to potential over-vote situations. If the intermediary subscribes to this service, Broadridge sends the intermediary an alert two days after the record date if the record date position shown on the intermediary's records is different from its ledger position at CDS/DTC. While this is helpful, it can only detect problems, not prevent them. We understand that Broadridge also makes it possible for the intermediaries to code the "non-clearing intermediaries" account so that they will not receive a proxy and an omnibus proxy would be generated and sent to the transfer agent to allow the non-clearing intermediary's clients to submit their votes directly to Broadridge or to the transfer agent, but intermediaries must elect to use this service. The solution to the problem lies not with Broadridge, but with its intermediary clients.

42 Issues Related to Broadridge's Place in the Market

42.1 Broadridge as Sole Repository of Market Information

We noted in Section 38 above, that virtually all of the information about the proxy voting system resides with the service providers, all of whom have an interest in the way in which the system operates. In our view, the most influential of the service providers is Broadridge. Virtually all information about non-registered investors flows through Broadridge. This puts Broadridge in a different position than even its intermediary clients because it has information about almost all of the non-registered investors (whereas each intermediary has access only to information about its own clients). No one else in the system has all of this information, unless it is provided to them by Broadridge. The transfer agents have information about the registered shareholders (and about some NOBOs), but with much of the market shared by the two largest providers, none of them is in the same position as Broadridge with respect to the information it controls.

As the sole source of this information, Broadridge is in a powerful position. It has used this position to provide assistance to regulators and others who are seeking to understand and evaluate the system. It regularly provides market updates to those who it knows have an interest in the proxy voting system. It has also used this information to streamline the system and to make it more effective and to develop solutions to some of the problems the system presents.

As a matter of observation rather than criticism, it should be noted that Broadridge is in a position to make choices about the form and content of the information it releases (as are the other service providers). An outside observer may ask questions of Broadridge and may find Broadridge very responsive. However, the process of understanding the system in this way resembles a party game in which a guest must name an object in a box by asking questions about what it might be rather than just looking into the box. Our understanding of the proxy voting process as it affects non-registered investors is greatly limited by not being able to look independently into the Broadridge box.

When data and analysts in connection with market incidents are required, Broadridge also benefits from its unique position in the marketplace. For example, Broadridge was retained to work with the mutual fund companies involved with market timing in 2005 and in connection with the asset-backed commercial paper issue in 2008.

42.2 Is Competition Necessary or Desirable in OBO Distribution and Tabulation?

As noted elsewhere in this paper, in Canada virtually all of the brokers and other intermediaries have delegated to Broadridge the role of disseminating proxy materials to, and tabulating voting instructions from, OBOs (this activity is referred to in this section as OBO distribution and tabulation services). No one else offers a comparable service in Canada. As a result, if an intermediary does not wish to use Broadridge's services, it must self-supply these services by maintaining a separate proxy distribution service. Broadridge enjoys a similar near-monopoly position in the U.S. marketplace[396] where it has been the subject of frequent comment by various industry participants.[397] Such comment includes criticisms that the lack of competition for OBO distribution and tabulation services has led to higher prices, reduced innovation and inadequate service levels.

Some have suggested that OBO distribution and tabulation services are a "natural" monopoly, meaning that the most efficient system is realized by having a single supplier of such services.[398] While it may be true that a single supplier of proxy services could, in principle, be more efficient than maintaining separate proxy distribution departments at each broker, it is also possible that greater diversity of competitors would result in lower prices, more choice for customers, increased service offerings and higher service levels. Vigorous competition also compels firms to reduce costs, increase efficiency and acts as a key driver for innovation, such as technological advances. Although more study and information is necessary to determine whether increased competition in the supply of proxy distribution would be sustainable, potential explanations for the absence of effective competition to Broadridge are discussed briefly below.

42.3 Why Does Broadridge Have No Competitors in the Canadian Marketplace?

42.3.1 Is Broadridge Simply More Efficient Than Anyone Else Could Be?

It is important to understand why there is a lack of effective competition in Canada for OBO tabulation and mailing services. As noted above, it is possible that this market is a "natural monopoly". Even if it is not, it is of course possible that Broadridge is an efficient supplier that offers a highly competitive and uniquely efficient service such that potential competitors are discouraged from entering the marketplace.

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396 In the United States, there are currently two small competitors to Broadridge: Mediant Communications LLC and Inveshare, Inc.

397 See e.g. Eric Jackson, "Break-up the Broadridge monopoly on counting shareholder votes" (16 July 2009) (blog), online: Breakout Performance <http://breakoutperformance.blogspot.com/2009/07/break-up-broadridge-monopoloy-on.html>; Chris Kentouris, "A proxy statement: Broadridge holds a monopoly. should it?" (7 September 2009), online: All Business <http://www.allbusiness.com/company-activities-management/company-structures-ownership/12882698-1.html> [Kentouris].

398 Kentouris, *ibid*.

This is the explanation offered by consultants Compass Lexecon in a report recently commissioned by Broadridge.[399] They argue that the high share of the market for proxy services held by Broadridge is attributable to the fact that it is a "low cost" and "efficient provider" of such services and that the limited entry by competitors is simply evidence of this. For reasons discussed in the next section under "fees", it is difficult to agree with or refute this point without access to more information about Broadridge, such as its costs and margins and in the absence of an independent analysis of this data.

42.3.2 Relationship with Intermediaries

One factor that may contribute to the apparent absence of competition in the supply of OBO distribution and tabulation services is the fact that although it is the intermediaries that retain Broadridge, it is the issuers that pay Broadridge.[400] Consequently, higher prices for Broadridge's services may not lead to reduced demand by intermediaries nor encourage intermediaries to seek out competitive alternatives for these services. In fact, intermediaries may even benefit from higher prices if they receive a share of the fees charged by Broadridge.[401]

The structure of the relationship between the intermediaries, Broadridge and the issuers results in what is referred to as a "negative externality" for issuers. An externality is the effect of a decision on parties who did not participate in the decision-making process and whose interests were not taken into account in the making of the decision. In the case of proxy services, the decisions of brokers to outsource such services to Broadridge may result in higher costs and other negative effects for issuers. This negative externality, together, in some cases, with the potential to share in increased fees, may explain the relative passivity among intermediaries with respect to prices and other terms upon which these services are supplied by Broadridge.[402]

42.3.3 Barriers to Entry

Another factor that may contribute to the apparent lack of effective competition in the market for OBO distribution and tabulation services may be high barriers to entry for new suppliers of proxy services. Barriers to entry can include significant costs that are not recoverable upon exit from the market ("sunk costs"), regulatory barriers, the behaviour of incumbent firms that deter entry and the need to achieve sufficient scale of operation to become a viable competitor. For OBO distribution and tabulation services, for example, a new entrant would have to incur various costs, including the acquisition and development of the systems for distributing proxy materials

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399 Compass Lexecon, "An Analysis of Beneficial Proxy Distribution Services" (May 11, 2010), on file with authors [Compass Lexecon Report].

400 Elizabeth Judd, "Proxy fulfillment: a new world of choice" *Corporate Secretary* (1 June 2009), online: <http://www.corporatesecretary.com/articles/11204/proxy-fulfillment-new-world-choice/>.

401 The SEC Concept Release, *supra* note 31 at 57, notes that Broadridge pays certain of the larger intermediaries some portion of the fees that it collects from the issuers. We have heard anecdotally that this is also the case in Canada, but have not had this confirmed by Broadridge or any of the intermediaries.

402 As one U.S. shareholder group observed: "Since public companies pay for these services - and brokers and banks select Broadridge as their service provider - there [are] very few incentives in the system to improve its efficiency or reduce costs". See Shareholder Communications Coalition, "How stocks are voted", online: <http://www.shareholdercoalition.com/stockvoting.html>.

and tabulating voting instructions, a significant proportion of which would not be recoverable if the firm were later to exit from the market. However, perhaps the more significant sunk costs for a new entrant would be the investment necessary to establish the firm as a reliable supplier of proxy services. In this regard, Broadridge holds a significant advantage as an incumbent firm with a strong reputation for reliability.

In addition to these sunk costs, a new entrant may also face barriers due to long-term contracts which exist between Broadridge and intermediaries, as these contracts could make it more difficult to attract a sufficient customer base to be profitable. In addition, Broadridge often bundles its proxy services with related services as part of an integrated service offering. The need to compete against such bundled service offerings makes it more difficult for a new entrant to offer a competing service that is confined to only proxy services, without offering the related services supplied by Broadridge. This has the effect of requiring firms to enter on a larger scale, with a broader service offering.

The limited success of new entrants in both the Canadian and U.S. markets for proxy services supports the suggestion that barriers to entry are high. For example, in 1992, the transfer agents in Canada established a firm called Benequity to compete with Broadridge. However, this initiative lasted for only 18 months before it ceased operation. In the United States, Mediant Communications began offering proxy services in 2008, but has not been successful in capturing a significant share of the market.[403] As one former vice-president of Broadridge noted in a 2009 article:

> I don't think that Broadridge ever intended to become a monopoly, but it is how it ended up … The cost of maintaining a giant mailing facility to collect and mail out proxy materials was a multimillion dollar initiative so the cost of entry was far too high for any competitor to last.[404]

42.3.4 Potential for Increased Competition

Although there appears to be a lack of effective competition for proxy services today, there remains the potential that developments in the market, such as technological advancements or regulatory changes, may result in greater competition in the future. For example, a growing reliance on electronic distribution of proxy materials and voting may allow for entry by firms that operate on a smaller scale and with fewer sunk costs by focusing exclusively upon electronic distribution. In addition, significant transfer agents currently operating in the United States could begin offering proxy services as they expand their service offerings. As noted above, the threat of entry by such firms may act as a competitive constraint on Broadridge, provided that intermediaries are prepared to consider alternative suppliers of these services. Finally, proposed regulatory reforms (as discussed elsewhere in this paper) may either introduce greater competition for the supply of proxy services or regulate Broadridge's activities.

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403 See e.g. Directorship, "New proxy participant in town" (24 November 2008), online: <http://www.directorship.com/new-proxy-player-in-town/>.

404 Kentouris, *supra* note 397.

42.4 What Impact Does Broadridge's Place in the Market Have on Fees Paid by Issuers?

The near-monopoly position held by Broadridge and the absence of effective competition do not necessarily mean that the prices and services offered by Broadridge are uncompetitive. For example, even a credible threat of new entry by a competitor may act as a competitive constraint on the prices charged by Broadridge.

However, the absence of effective competitors does make it difficult to determine whether Broadridge's pricing and service levels are consistent with competitive levels. Reports commissioned by Broadridge, such as the Compass Lexecon Report referenced above, do not provide the information necessary to make that assessment on an independent basis. The Compass Lexecon Report does not, for example, discuss the profit margins earned by Broadridge, whether fees are closely related to Broadridge's costs of providing the service or discuss examples of where Broadridge has reduced fees in response to competitive threats, such as a threat by brokers to perform services in-house or to use a rival provider of services.

42.5 How Are Broadridge's Fees Set?

42.5.1 How Broadridge's Fees Are Set in the United States

42.5.1.1 Role of NYSE

In the United States, Broadridge's fees are set in part by the NYSE.[405] The SEC Concept Release details the history of the NYSE requirement for issuers to reimburse its members for out of pocket costs of forwarding proxy materials. Reimbursement rates were first set in 1952 and have been revised from time to time since then. The most recent review of the NYSE's fee structure came in 2006 by the Proxy Working Group.[406] The SEC Concept Release refers to the following comments in that group's report:

- the fees "may be expensive to issuers but generally result in shareholders receiving and being able to vote proxies in a timely manner. This is an important benefit of the current system;"[407]
- issuers and shareholders deserve periodic confirmation that the system is performing as cost-effectively, efficiently and accurately as possible, with the proper level of responsibility and accountability in the system;[408] and

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405 NYSE Rule, 465 prescribes the current fees as follows: (1) A "Base Mailing Fee" of $0.40 for each beneficial owner account when there is not an opposing proxy; (2) An "Incentive Fee" of $0.25 per beneficial owner account for issuers whose securities are held by many beneficial owners and $0.50 per account for issuers with few beneficial owners; (3) A "Nominee Coordination Fee" of $20 per "nominee"; and (4) An additional "Nominee Coordination Fee" of $0.05 per beneficial owner account for issuers whose securities are held by many beneficial owners and $0.10 per account for issuers with few beneficial owners. See SEC Concept Release, *supra* note 31 at 52-53.

406 NYSE Proxy Working Group, *Report and Recommendations of the Proxy Working Group to the New York Stock Exchange* (5 June 2006), online: <http://www.nyse.com/pdfs/REVISED_NYSE_Report_6_5_06.pdf >.

407 SEC Concept Release; *supra* note 31 at 55.

- the NYSE should "continue to explore alternative systems such that a competitive system, with fees set by the free market, could eventually succeed the current system."[409]

The Proxy Working Group recommended that the NYSE engage an independent third party to analyze and make recommendations regarding the structure and amount of fees paid under Rule 465. It also recommended that the NYSE study Broadridge's processes and the business processes by which the distribution of proxies occurs. Although it has been four years since this recommendation was made, this review has not yet been done.

42.5.1.2 Other Issues

The SEC Concept Release also catalogues several specific issues relating to fees paid for proxy delivery.

First, not all services provided are captured by the NYSE fee structure. For example, neither the NYSE nor any other SRO has established maximum fees that member firms may charge under the notice-and-access model. The SEC Concept Release notes as follows:

> If an issuer elects the "notice-only" delivery option for any or all accounts, that proxy service provider currently charges an "Incremental Fee," ranging from $0.05 to $0.25 per account for positions in excess of 6,000,130 in addition to the other fees permitted to be charged under NYSE Rule 465. This Incremental Fee is charged to all accounts, even if the issuer has elected to continue "full set" delivery to some accounts. Several issuers have expressed concerns about these fees associated with the notice-and-access model.[410]

Second, the SEC Concept Release notes that Broadridge bills issuers the maximum fee allowed by the NYSE, but charges its largest intermediary clients less than the maximum fees, with the result that Broadridge remits funds back to some of its largest clients. The SEC Concept Release notes that this practice raises the question as to whether the fees in the NYSE schedule currently reflect "reasonable reimbursement".[411]

Third, the SEC notes the practice with respect to Incentive Fees, which are put in place to encourage intermediaries to reduce proxy distribution costs on behalf of issuers on the theory that intermediaries would otherwise have no incentive to reduce the issuer's forwarding costs. The SEC reports that when a paper mailing is suppressed the first year and the Incentive Fee is collected, the intermediary or its agent (typically Broadridge) continues to collect this fee each

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408 *Ibid.*

409 *Ibid*. at 54-55.

410 *Ibid*. at 56.

411 *Ibid.* at 57.

subsequent year, even though their continuing role is limited to keeping track of the fact that the investor has elected not to receive a paper mailing.[412]

Finally, the SEC Concept Release notes the practice used in the case of certain managed accounts, where hundreds or thousands of beneficial owners may delegate their voting decisions to a single investment manager. The SEC's understanding is that the Base Mailing Fee and the Incentive Fee are assessed for all accounts, even though only one set of proxy materials is transmitted to the investment manager.

42.5.2 How Broadridge's Fees Are Set in Canada

The fees payable by the issuer to the intermediaries for delivery of proxy materials to investors were first established under NP 41 as $1.00 per beneficial record. [413] When NP 54-101 was introduced in 2002, there was no provision in the instrument for the determination of these fees, leaving the fees payable by the issuer subject to the provision that they must be a "reasonable amount". This provision remains unchanged.[414] The provisions of the Companion Policy dealing with fees also remains unchanged since it provides in part as follows:

> 2.6 …In determining what is a reasonable amount the Canadian securities regulatory authorities expect that market participants will be guided by fees previously prescribed by Canadian securities regulatory authorities and by the fees payable for comparable services in other jurisdictions such as the United States, as well as by technological developments…

In Canada, Broadridge sets its own fees, subject only to the requirement in NI 54-101 that the fees be reasonable.[415]

Broadridge notes that its fees have not changed since 1987 when fees were regulated at $1.00 per beneficial record. Broadridge also notes that the cost of living has increased 69.4 percent since 1987 and so the industry has benefited. One might also consider whether technological advances have resulted in significant cost reductions and whether those cost reductions have been reflected in fees charged. Broadridge retains Charles Rivers Systems and Deloitte & Touche to conduct economic and market analysis upon which its fees are based.

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412 *Ibid*.

413 NP 41, s. 7 provided as follows: "An issuer shall pay the fees and costs of an intermediary for its service in transmitting proxy-related material in accordance with Schedule 1 to this Policy Statement". Schedule 1 provided as follows:

> 1.
>
> (i) $1.00 per name of non-registered holder to whom the intermediary delivers proxy-related material, with a $15.00 minimum fee where there is at least one non-registered holder.
>
> (ii) The actual cost of postage incurred by the intermediary in delivering the proxy-related materials in ***the underlying owners***.

414 NI 54 101, s. 1.4.

415 *Ibid*.

In our view, issuers are entitled to understand how the fees they pay to Broadridge are determined. Since there is no independent review of Broadridge's fees and no apparent competitive discipline, it is impossible to verify whether its prices are fair from the perspective of the issuers that must pay them. For example, are all of the fees charged determined through agreement with the intermediaries or are there some fees that are set outside of those agreements (and therefore not subject to any counter party discipline)? Is $1.00 per record still an appropriate amount and why is a different, unbundled fee charged when Broadridge does not do the NOBO mailing? In other words, the Broadridge fees and the methodology by which they are set should be unpacked and explained.

43 Empty Voting

43.1 Where the Concern Lies

Empty voting has the potential to compromise the underlying principles of shareholder democracy. Shareholders are generally believed to be motivated by their own economic interest in casting their votes (although some investors also have environment, social and governance – referred to as ESG – priorities). When that economic interest is separated from the right to vote, the motivation of the person casting the vote can come into question. In extreme cases, the motivation of the person who votes the shares could be contrary to the financial interests of the company and its shareholders.

Before suggesting that action must be taken to prevent empty voting, the rights of the person who has invested in a security must be considered. Surely an investor has the right to use its investments to maximize its own economic position. That might involve earning a fee by lending or granting some other participation in that security, for example. To suggest that the investor give up the full use of the asset because someone else (the borrower, for example) might use the vote in a manner that might be unacceptable to other shareholders is a difficult case to make. Similarly, once an investor has acquired the right to cast a vote (for example, when a share has been borrowed), is it reasonable to impose restrictions on the way in which it casts that vote?

43.2 Evidence of the Problem

One of the major problems in deciding whether any action should be taken with respect to empty voting is that there is too little evidence that the problem exists or, if it does, that it has any adverse impact on shareholder democracy or on the integrity of the capital markets.

It is possible, of course, that with the exception of a few, well publicized examples, empty voting poses no real threat. Many borrowers of shares lend or use the borrowed shares to settle another position and, if they do maintain any interest in the shares, will not take the time to vote precisely because they have no economic interest in the issuer. Those who do may well do so on the same basis that they cast other votes they control - in accordance with a proxy voting policy, for example.

Of course, if empty voting were common or if it were used in a way that some might find objectionable, how would we know that?

43.3 Expansion of Regulatory Requirements to Reflect Derivative Instruments

43.4 What Should Be Done

43.4.1 Should Anything Be Done?

In our view, it is appropriate for the capital markets community to become better informed about the occurrence and impact of empty voting. One approach is information gathering, which will require more disclosure from those with a right to vote that has been "decoupled" from its associated economic interest. This is discussed in more detail below. Another is to encourage behaviours that will minimize the occurrence of empty voting, particularly to the extent that it will be detrimental to the interests of an issuer and its shareholders. In short, we believe it is important to develop better information about the frequency and effect of over-voting, but in developing solutions, to be conscious of not forcing change where empty voting exists, but is benign.

43.4.2 Disclosure Requirements

We believe that disclosure requirements should be reviewed in order to determine whether changes are required in order to provide the marketplace with better information about empty voting. Many of the rights acquired under derivative instruments do not fit clearly within existing categories for disclosure under the securities laws in Canada. The same issue has been considered in the United States.

There are two situations in Canadian securities law when an investor must disclose its shareholding. The first is when the investor is an insider. If the investor's only relationship with the issuer is as an investor, that obligation will typically not arise unless the investor holds at least 10 percent of an issuer's securities, a threshold which is much higher than in most other jurisdictions.[416] Once an investor is an insider, it must report certain transactions (such as the purchase or sale of securities in question). It must also disclose arrangements, agreements or understandings which have the effect of altering, directly or indirectly, the reporting insider's economic exposure to the issuer.[417] Without this requirement, the insider's holdings as publicly disclosed would no longer reflect the holder's true economic position in the issuer. This disclosure requirement covers a situation in which an investor has alienated its economic interest (but is still left with the voting share). The insider reporting rules do not address a situation in which an investor obtains economic exposure to 10 percent or more of an issuer's securities without having to report that interest. For example, a person could enter into total return equity swaps on 10 percent or more of the shares of a corporation with two different counterparties and none of the parties involved would be required to disclose their position. Two considerations need to be studied in connection with the current requirement. First, should the disclosure level be lowered so that the marketplace has better insight into significant positions in an issuer that are being formed? Second, do the existing provisions adequately capture synthetic positions?

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416 OSA, s. 101.

417 *Insider Reporting Requirements and Exemptions*, O.S.C. NI 55-104, (2010) 33 O.S.C.B. 645.

The other disclosure obligation arises in the early warning provisions of securities regulation. This disclosure applies to an investor who holds 10 percent of an issuer's voting or equity securities[418] and applies each time that investor acquires another 2 percent of those securities. These provisions of securities law are intended to alert the marketplace if the intentions of the investor change. There are many derivative positions that would not be caught by these provisions. An over-the-counter option or forward on a security and other derivatives transaction could be used to give a party exposure to a security without that party having to invest directly in such security.

Recent decisions in both the United States and Canada signal that instruments previously thought to be outside of the disclosure regime may be disclosable in contests for control, or possibly if used to avoid reporting requirements in other contexts.

In its 2006 decision in *Sears*,[419] the Ontario Securities Commission found that if swaps were used to "park securities" in the context of a take-over bid, in a deliberate effort to avoid reporting obligations and for the purpose of affecting an outstanding offer, this could constitute abusive conduct sufficient to engage the Commission's public interest jurisdiction.

The *CSX* decision[420] described a situation that was not clearly caught by applicable disclosure requirements. This U.S. decision involved a complaint by CSX Corporation against two large hedge funds (The Children's Investment Fund (TCI) and 3G Capital Partners (3G)) that initially acquired interests in CSX stock by entering into cash-settled "total return" swaps. The case focuses on the use of the swaps to obtain significant market power, without disclosure, over a year before the funds launched a proxy fight for five out of the 12 positions on the CSX board.

The swaps in question gave the hedge funds the economic exposure to the CSX stock, but no ownership of the stock or any right to acquire it. The court found, however, that the bank or other financial counterparty to a large total return swap almost always hedges its position through a matching purchase of shares. Moreover, the court noted that, at least in large swap transactions, it was easy for the "long" party (such as the funds) to close out the swap position by acquiring the underlying shares. Thus, the contracts enabled the funds to accumulate a substantial economic position (eventually over 14 percent of the outstanding stock in the case of TCI) through the swaps, but avoid actual ownership or market awareness of their position until they were ready to publicly announce their intentions with respect to the stock.

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418 OSA, s. 102.1(1). Every acquiror who acquires beneficial ownership of, or the power to exercise control or direction over, voting or equity securities of any class of a reporting issuer or securities convertible into voting or equity securities of any class of a reporting issuer that, when added to the acquiror's securities of that class, would constitute 10% or more of the outstanding securities of that class, shall disclose the acquisition in the manner and form required by regulation.

419 *Sears Canada*, *supra* note 330.

420 *CSX*, *supra* note 329.

Using the anti-avoidance principles of Rule 13d-3(b) under the *Exchange Act*, the CSX court found that TCI had acquired beneficial ownership of over 5 percent of the CSX shares through the use of the total return swaps. Accordingly, TCI had failed to report its interest in over 5 percent of the stock in a timely fashion on Schedule 13D. In addition, the court found that the communications between TCI and 3G, their similar buying patterns and preparations for a proxy fight were sufficient for them to constitute a "group" for purposes of calculating beneficial ownership under Section 13(d) of the *Exchange Act* as early as February 2007, again making their Schedule 13D filing belated. However, because all of the material facts were ultimately disclosed, the court found that the belated filings did not cause irreparable harm and the court did not grant relief beyond enjoining the funds from further violations of the securities laws.

43.4.3 Issuer

Issuers can also take some action to promote better disclosure in connection with important corporate events. This already occurs to a significant extent in the United States. For example, advance notice provisions are commonly included in the bylaws of U.S. companies. These provisions require anyone proposing, for example, to launch a proxy contest to include in the "advance notice" they are required to provide to the issuer, information about whether they hold synthetic equity without votes or votes relating to shares in which they have no economic interest. This allows shareholders to react to the proposal based on a more complete understanding of the dissident's interest in the issuer. In addition, many shareholder rights plans now include synthetic positions in the poison pill trigger language.

43.4.4 Other Practices and Proposals

There are a number of rules and proposed practices relating to empty voting in other jurisdictions that could be reviewed and evaluated to see if they would be useful in the Canadian context. For example, some European jurisdictions prohibit the transfer of shares within a specified number of days of voting those shares. Any benefit from such a rule would of course have to be weighed against the restrictions this would impose on investors and against the likely result that some investors would simply not vote their shares so as to avoid those trading restrictions.

The ICGN has been a leader in addressing empty voting from the investor perspective. In its "Securities Lending Code of Best Practice" (the "Code") (adopted in 2005 and amended in 2007) the ICGN proposed certain practices to curtail the occurrence and effects of empty voting. In connection with the responsibilities of borrowers, for example, the Code says that "it is never good practice for borrowers to exercise voting rights with respect to shares they have borrowed, except in the rare circumstances where they are acting pursuant to the lender's specific instructions". The Code explains the rationale for this guideline as follows:

> Borrowers have every right to sell the shares they have acquired. Equally the subsequent purchaser has every right to exercise the vote. However, the exercise of a vote by a borrower who has, by private contract, only a temporary interest in the shares, can distort the result of general meetings, bring the governance process into disrepute and ultimately undermine confidence in the market.

In addition, the Code makes three recommendations for issuers to ameliorate the effects of securities lending on proxy voting.

First, it recommends that issuers publish and distribute shareholder proxy materials, including public notice of the issues to be considered at the meeting, sufficiently in advance of the record date to permit the recall of shares that are on loan prior to the record date if required by the lender's policies or best practices. In many cases, however, this will not be practicable in light of current Canadian regulatory requirements, including advance record date requirements and mailing requirements, which have led to the general practice of mailing materials to shareholders on or shortly after the record date.

Second, the Code recommends that issuers separate the record dates for dividend payments and shareholder meetings, in order to minimize the effect on shareholder participation of dividend swaps that transactions in which shares are loaned over a dividend record date to a borrower that has a tax advantage *vis-à-vis* the lender in respect of the receipt of the dividend.

Third, the Code recommends that issuers and their agents should take care in their recordkeeping and the administration of shareholder voting to identify and expose over-voting and empty voting.

In view of the issues with the proxy voting system in Canada as discussed in this paper, this solution would only be achievable with the sharing of information and other forms of cooperation that do not currently exist among the various players in the proxy voting system.

44 Addressing the Power of the Proxy Advisory Firms

44.1 Role in the Mechanics

The voting platforms operated by proxy advisory firms such as ISS and Glass Lewis form part of the plumbing in the proxy voting system. They take voting instructions from their institutional investor clients and deliver those instructions – usually to Broadridge – through their voting platforms. Potential for administrative error exists – both computer and human – just as it does in other parts of the mechanics of the proxy voting system. As is the case with errors that occur in other parts of the system, the investor will seldom know if an error has been made because there is very little capacity in the system for the proxy advisory firm to be able to confirm back to the investor that its voting instructions have been fully reflected in a properly cast vote.

44.2 Reliance of Institutional Investors on the Proxy Advisory Firms

Proxy advisory firms analyze proxy materials and provide voting recommendations to their institutional clients. These are based on the proxy advisory firm's voting guidelines. Often, the institutional client will have its own voting guidelines (or may develop such guidelines with the assistance of the proxy advisor). The institutional investor may instruct the proxy advisor to submit its voting instructions based on the proxy advisor's guidelines or on the investor's own guidelines (if it has them). Alternatively, the investor may make voting decisions based on the issue peculiar to a particular issuer.

The recommendations of proxy advisors can be determinative of the outcome of the meeting. In some cases, issuers purposely frame their decisions and their recommendations to shareholders in a way that they know the proxy advisory firms will support. The considerable power that a recommendation from a proxy advisory firm wields as a result stems from the willingness of their investor clients to follow those recommendations. Many investor clients do so because they have considered and agree with the recommendation. In other cases, they may not have considered the issue independently, but are prepared to rely on the proxy advisor's recommendation because they believe they are aligned with the proxy advisor's voting guidelines.

The reliance by institutional investors on proxy advisory firms has been the subject of considerable commentary in the United States. Some suggest that certain investors ─ such as fund managers ─ find the cost of formulating their voting decisions without the support of third-party research and recommendations to be prohibitive. [421] Others view the reliance of institutional investors on proxy advisory firms as "a form of insurance against regulatory criticism".[422] In addition, regulation in the United States that requires public funds to disclose their complete voting record and that requires them to adopt policies and procedures reasonably designed to ensure that proxies are voted in the best interests of the funds' clients[423] have further encouraged outsourcing to "expert" agents like ISS.[424] The combined result, some say, is that "some institutional investors will simply follow ISS's advice rather than do any thinking of their own"[425] ─ meaning that the outcome of a given shareholder vote "may well be determined by what position ISS has taken on the matter".[426]

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421 George W. Dent, Jr., "The Essential Unity of Shareholders and the Myth of Investor Short-Termism", (2010) 35 Del. J. Corp. L. 97 at 135.

422 Leo E. Strine, Jr., "The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (And Europe) Face", (2005) 30 Del. J. Corp. Law 673 at 688.

423 NI 81-106, ss. 10.2(1) ("establish policies and procedures"), 10.3 ("maintain a proxy voting record").

424 Tamara C. Belinfanti, "The Proxy Advisory and Corporate Governance Industry: The Case for Increased Oversight and Control" (2009) 14 Stan. J.L. Bus. & Fin. 384 at 397. at 393. Such regulation imposing this pressure on mutual funds exists both in Canada and the United States.

425 Strine, *supra* note 422 at 688.

426 David P. Porter, "Institutional Investors and Their Role in Corporate Governance: Reflections by a 'Recovering' Corporate Governance Lawyer", (2009) 59 Case W. Res. L. Rev. 627 at 667; see generally Jennifer E. Bethel & Stuart Gillan, "Corporate voting and the proxy process: managerial control versus shareholder oversight" (June 2000), online: <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=236099>.

Of course, just because institutions vote in the same manner as proxy advisors recommend, it does not mean the institutions are merely following the advisors' recommendation. In many cases, both the advisors and the institutional investors share the same approach to a specific issue, such as removing anti-takeover protections.

The discussion on the reliance of institutional investors on proxy advisory firms will continue in the United States in the context of comments on the SEC Concept Release. The SEC Concept Release states in part as follows: "…we are considering the extent to which the voting recommendations of proxy advisory firms serve the interests of investors in informed proxy voting and whether, and if so how, we should take steps to improve the utility of such recommendations to investors." In its comment letter, CII responded in part as follows:

> Proxy advisory firms play an important role in helping pension fund managers fulfill their fiduciary duties with respect to proxy voting by providing an analysis of issues on the ballot, executing votes and maintaining voting records. Without proxy advisers, many pension plans—particularly smaller funds with limited resources—would have difficulty managing their highly seasonal proxy voting responsibilities for the thousands of companies in their portfolios….Some observers contend that proxy advisory firms' recommendations have too much influence on the outcome of voting at U.S. public companies. The Council disputes this view. … The notion that proxy advisory firms "control the institutional vote" wrongly assumes that institutions are a unified bloc of voters. In fact, many institutional investors are passive voters that defer routinely to the recommendations of management. We note that state and local pension funds, whose ranks include many of the most activist investors, hold just 6 percent of total outstanding equity.

The issue of reliance by institutional investors on proxy advisory firms is also being considered in other jurisdictions. In the United Kingdom, the Financial Reporting Council recently released its U.K. Stewardship Code recommending a disclosure regime under which institutional investors disclose how they use proxy advisory firms. In Canada, the CCGG deals with these issues in its 2005 Statement of Principles Regarding Member Activism. The CCGG expects to release a revised version of this statement in early November 2010.

44.3 How Recommendations Are Developed

Another important question is how proxy advisory firms generate their recommendations. Each proxy advisory firm uses different proprietary processes to generate their voting recommendations. These processes differ in the selection of particular factors that affect their recommendations and the weight given each factor differs from firm to firm.[427] Commenters in the United States underscore the importance of investors who rely on proxy advisory services understanding the basis on which the proxy advisory firm develops its recommendations. Without this understanding, they argue that the investors' reliance on the proxy advisory firm may be uninformed[428] – and in some cases not appropriate.[429] ISS has provided us with the following explanation of the consultation process it adopts to develop policies and recommendations that reflect the views of its clients:

> Institutional clients of ISS have extensive opportunity to provide input and feedback on policy issues every year post proxy season. Rigorous policy outreach efforts are undertaken that in Canada take the form of one-on-one client meetings in which policy issues from the season just finished and those anticipated for the coming season are discussed at length. Those clients who are unable to meet due to scheduling conflicts are given the opportunity to comment on proposed policy updates for a 2-week period before all policies are finalized. In addition, ISS analysts communicate with institutional clients during the course of proxy season on a range of issues including those that are highly contentious. ISS also communicates regularly with the CCGG and PIAC with regard to policy development and update issues. ISS also holds a series of roundtables and webcasts on policy topics of interest for the coming proxy season. Finally, all market policy documents are available on the ISS website for easy access by both institutional investors and the issuer community.

In contrast, the Glass Lewis model in developing its guidelines places greater reliance on its own expertise and research. They have provided us with an explanation of their procedures for evaluating proxy proposals:

> Glass Lewis develops its proxy voting guidelines in consideration of its global corporate governance principles to, among other things, encourage board accountability, link executive pay to performance and promote shareholder rights. Glass Lewis' proxy voting guidelines are tailored to the specific characteristics of each country based on local regulations, best practice codes and market practices. To ensure its approach reflects current practice, Glass Lewis' analysts continuously monitor local regulatory developments and local country governance associations like the CCGG and PIAC in Canada and the CII in the U.S.. While Glass Lewis consults frequently with clients on the utility of its research, Glass Lewis believes the value of its research is to provide clients with an independent perspective on various issues. Further, in developing

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427 Stephen J. Choi, *et al.*, "Director Elections and the Role of Proxy Advisors" (2009) 82 S. Cal. L. Rev. 659. Specifically, ISS focuses on governance-related factors; PROXY Governance, Inc. on compensation-related factors; Glass, Lewis & Co. on audit/disclosure-related factors; and Egan–Jones Proxy on an eclectic mix of factors.

428 *Ibid*.

429 On this topic, see also Belinfanti, *supra* note 424; Jeffrey Sonnenfeld, "Good Governance and the Misleading Myths of Bad Metrics", (2004) 18 Acad. Mgmt. Executive 108, at 127.

> and revising our policies, we consult with clients and with the Glass Lewis Research Advisory Council, whose members provide a global perspective based on their expertise in law, compensation, accounting, governance, finance and management.

A frequent criticism of proxy advisory firms is that they adopt a one-size-fits-all model to corporate governance, without taking into account key factors that may dictate the appropriate governance policies that a company should employ, such as the stage of development that a company is in, its size, or the industry within which it operates.[430] In its comment letter to the SEC on the SEC Concept Paper, Wachtell, Lipton, Rosen & Katz was highly critical of the power of the proxy advisory firms, including on this issue:

> Proxy advisory firms have taken it upon themselves to hold issuers to a narrow, one-size-fits-all set of practices. This has led and continues to lead to widespread adoption of practices without case-by-case consideration of whether the practices are warranted or beneficial to the individual company. As the proxy advisory firms have grown stronger, they have used their influence to cause issuers to dismantle their takeover defenses, despite evidence that strong defenses in the hands of a responsible board tend to produce better outcomes for shareholders. The rise of the proxy advisory firms has been accompanied (and this is not merely coincidental) by a marked drop in the number of corporations with classified boards or shareholder rights plans. This creates a vicious cycle in which issuers, increasingly vulnerable to unsolicited bidders or activist investors, feel pressured to accept advisory firm governance policies and activist shareholders' economic proposals, regardless of whether those policies or proposals are in the best interests of the corporation or its shareholders generally.[431]

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430 "Companies need the ability to adapt their leadership structures to their individual circumstances depending on the needs of the company at any particular time in its evolution." *Corporate Governance and Shareholder Empowerment: Hearing Before the Subcomm. on Capital Markets, Insurance, and Government Sponsored Enterprises*, 111th Cong. (Apr. 21, 2010), 2010 WLNR 8232658 (Congressional Testimony via FDCH on WL). By contrast, a 2003 empirical study suggested that companies that depart from best practices for valid reasons outperform their "fully compliant" competitors.

431 Comment Letter from Wachtell, Lipton, Rosen & Katz to SEC, "Comments on Release No 34-62495; IA-3052; IC-29340; File No. S7-14-10" (19 October 2010).

Wachtell Lipton also argues that additional regulation of proxy advisory firms is necessary for the protection of investors:

> Unlike the issuer's board of directors, the proxy advisory firms owe no fiduciary duty to the issuer's shareholders or its other constituencies. This is a dangerous gap in the securities laws which should be corrected. It is appropriate for proxy advisory firms to be regulated as investment advisers under the federal securities laws, and for their recommendations to be treated as soliciting material subject to the federal proxy rules.[432]

ISS and Glass Lewis both believe that their analysis and recommendations are much more calibrated than this criticism suggests. ISS advises that it has country and market specific voting policies that reflect best practices expectations in each market. It has two distinct proxy voting policies in Canada tailored for the different market components – TSX and TSX Venture. Within the TSX policy, ISS has a policy section that applies solely to the largest and most widely held companies in the S&P/TSX Composite Index. Beyond these differences, the Canadian policy is purposely drafted to provide flexibility where needed in order to be relevant for the Canadian "comply-or-explain" governance regime. ISS's Canadian analysts have some flexibility in applying policy taking into consideration the particular unique circumstances of a reporting issuer if warranted. In making voting recommendations, Glass Lewis advises that its analysts conduct a detailed analysis of each issue at each company. The Glass Lewis analysts have discretion to make case by case decisions for issues at all companies regardless of size, maturity, country or specific exchange listing.

44.4 Engagement with Issuers

ISS and Glass Lewis take different perspectives on engagement with issuers.

For the most widely held companies in the S&P/TSX Composite Index only, ISS circulates its report and recommendations to the issuer in advance of releasing it and gives the issuer an opportunity to vet the report for factual content only. Glass Lewis does not meet with issuers once the proxy materials have been sent out, because they believe it is more appropriate to restrict their analysis and recommendations to the issuer's public disclosure. Exceptions are made in the case of contested meetings, certain major transactions or other unique circumstances, where Glass Lewis will meet with the issuer and dissidents on a call with some of its clients. It does not provide issuers with an opportunity to comment on its report and recommendations before it is released.

Both ISS and Glass Lewis engage with issuers outside of the proxy season. ISS engages with issuers (without charge to the issuer) who wish to discuss their voting policies and the application of those policies. Glass Lewis generally meets with issuers at their request or in meetings organized by organizations such as the NACD or the ICD.

However, issuers are often concerned that the recommendations made by some proxy advisory firms are based on an incomplete or incorrect read of the issuer's public disclosure. In some cases, the proxy advisory firms are unwilling to accept or consider feedback from the issuers,

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432 *Ibid*.

resulting in recommendations to institutional clients that are either inaccurate or potentially misleading.[433] In its response to the SEC Concept Release, Dupont, a major U.S. issuer, wrote as follows:

> Although, as noted in the Release, proxy advisory firms typically represent that their analysis and recommendations are prepared with a view to maximizing long-term shareholder value for their clients[6], those firms themselves have no economic interest in that long-term shareholder value. Furthermore, they are not today subject to sufficient oversight. Eliminating their exemption from the Commission's proxy solicitation rules would be a step in the right direction.
>
> Proxy advisory firms remain subject to the prohibition on false and misleading statements under Rule 14a-9, but additional measures must be taken to ensure that the information in proxy advisory firm analyses and recommendations has been properly reviewed and vetted by the issuer. Issuers should be given a sufficient amount of time to review and comment on a proxy adviser's report. To the extent there is a disagreement that cannot be resolved through a formal appeals process, the proxy adviser's report should disclose that disagreement.
>
> Often, an issuer has one or two days to review and comment on the report and vote recommendations of a proxy adviser. It has been our experience that substantive disagreements over content, such as peer group analyses, are rarely resolved in favor of the issuer. In fact, we have disagreed with a proxy adviser's presentation of our Company's executive compensation figures, a subject that the Commission has extensively regulated.
>
> A proxy adviser should also be subject to additional disclosures aimed at improving the quality of ratings and recommendations, including disclosures of the depth of its research on recommendations, the effectiveness of its controls over accuracy of issuer data, the procedures for communications with issuers and the appeals process that applies in the event of disagreements over content.[434]

44.5 Conflicts of Interest

Where a proxy advisory firm offers not only corporate governance ratings and advice on proxy voting, but also provides advice to directors and managers of the same companies on how to improve the ratings that they assign (as ISS does), issues of conflicts of interest are raised.[435] This is the case for ISS but not for Glass Lewis. Conflicts may also exist where the proxy advisory firm (or its shareholders or senior executives) have business relationships with issuers and investors.[436]

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433 This concern was also identified in the SEC Concept Release, *supra* note **31** at 118.

434 Comment letter from Dupont to SEC, "Comments on Release No 34-62495; IA-3052; IC-29340; File No. S7-14-10" (19 October 2010).

435 Paul Rose, "Corporate Governance Industry" (2007) 32 J. Corp. L. 887 at 891.

436 Broc Romanek, "GAO report on proxy advisors: no smoking guns", *The Harvard Law School Forum on Corporate Governance and Financial Regulation* (3 August 2007) (blog), online: <http://blogs.law.harvard.edu/corpgov/2007/08/03/gao-report-on-proxy-advisors-no-smoking-guns/>.

ISS has advised us that it mitigates conflicts of interest between these divisions in several ways. They are run from different locations and are led by and staffed by different employees. Their internal databases are not accessible outside of that division and are secured and password protected. It also makes available to its institutional clients the results of an independent third-party SAS 70 audit of its processes and internal controls for mitigating potential conflict. In contrast, Glass Lewis does not solicit nor provide consulting services to the corporate issuers whose proxy proposals it analyzes

44.6 What Should Be Done

The real concern with proxy advisory firms is that the considerable influence they have is not balanced by any real accountability. While they are certainly contractually accountable to their clients, they are not accountable to the issuers for the quality of their analysis or recommendations. The issuers perceive the proxy advisory firms as being self appointed standard setters for corporate governance. ISS believes that it is simply articulating the standards that their investor clients have told them are important. Glass Lewis believes its recommendations reflect its own professional and expert analysis of the issues put to shareholders for decision.

It is not a stretch to suggest that many issuers have a considerable distrust of the analysis and recommendations of proxy advisory firms. One of the challenges in dealing with this issue is that these issues are not being addressed through any organized forum through which issuers may express their concerns. It would be appropriate for the CSA or the TMX Group to collect information from the issuer and investor community and assess whether there are issues that need to be addressed through regulation. The CSCS would also be an appropriate forum in which to discuss these issues.

Issuers are also concerned that they have no recourse when they believe that a proxy advisory firm is understanding or analyzing their issues incorrectly. This is discussed in Section 5.

45 Role of Investors in An Effective Proxy Voting System

45.1 Role of Institutional Investors

45.1.1 Duty to Vote

Investors who hold their interest in a share for their own account – such as most retail investors – are free not to vote their shares for any reason.

Different considerations apply if an investor holds their interest in a share on behalf of someone else. Institutional investors, for example, hold their interest on behalf of their clients or plan beneficiaries and have a duty to their clients or plan beneficiaries to deal appropriately with the assets they hold on their behalf.[437] That duty will typically (but may not always) require the institutional investor to vote its shares, whether to protect the long-term value of the investment or to approve or disapprove an action or event that may effect the investment in the short term. Most organizations representing the views of institutional investors emphasize the importance of being an "active investor," generally meaning that institutional investors should vote all of their shares and should do so on an informed basis. They should not, for example, automatically vote in favour of management. In Canada, the CCGG deals with this issue in its "Statement of Principles Regarding Member Activism".[438] Internationally, institutional investors have expressed their views through the ICGN's "Statement of Principles on Institutional Shareholder Responsibilities"[439] and through the "Principles for Responsible Investment".[440]

The recently released NYSE Corporate Governance Report[441] adopted as one of its 10 principles the responsibility of shareholders to vote their shares:

> Shareholders have the right, a responsibility and a long term economic interest to vote their shares in a thoughtful manner, in recognition of the fact that voting decisions influence director behavior, corporate governance and conduct, and that voting decisions are one of the primary means of communicating with companies on issues of concern.

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437 Whether investors - particularly institutional investors – owe a broader duty (to the capital markets, for example) is often discussed, but cannot, in our view, be a determinative issue. If the need arose to choose between the interests of the marketplace and the interests of its investors, for example, institutional investors would of course be compelled to focus on the interests of its investors. In Canada, the CCGG has state that the primary duty of its members in all matters, including dealings with issuers, is to their beneficiaries and not to the wider public. Canadian Coalition for Good Governance, "Statement of Principles Regarding Member Activism" (16 February 2005), online: <http://www.ccgg.ca/site/ccgg/assets/pdf/Statement_of_Principles-Member_Activism__Rev._Version_-_Feb_16_2005_.pdf>. We understand that this document is in the process of being updated.

438 *Ibid*.

439 See ICGN, online: <http://www.icgn.org/about/>.

440 See PRI, "Principles of responsible investment", online: <http://www.unpri.org/principles/>.

441 NYSE Corporate Governance Report, *supra*, note 38.

In the explanation of this principle, the NYSE Corporate Governance Report states that the "…Commission believes that the right to vote the shares of a company is a basic right and duty of share ownership, and that shareholders should vote their shares in a reasoned and responsible manner."

45.1.2 Voting vs. Share-Lending

While institutional investors may have a duty to cast the votes attaching to the shares they hold, that duty may come in conflict with the opportunity to earn additional revenue for the clients or plan beneficiaries by lending those shares.[442] This issue can be quite complex. Some believe that the revenue generated by leaving a share out on loan can be worth more to the beneficiaries or clients than the vote being cast (again, particularly if the institution has only a small position). Others believe that this is seldom an acceptable reason not to vote, particularly since the revenue generated from share-lending is not significant.

What is the result if investors are not able to vote their securities because they have loaned those shares? The result, obviously, will depend on how other investors (possibly including the borrower) vote. There may be no cost from the institution's perspective to the decision not to recall securities, and thereby forgo voting, if the result of the shareholder vote is ultimately consistent with the way in which the institution would have cast its vote, and it may consider itself to be in a better position for having earned the fee on the share-lending transaction and having not disrupted its securities lending arrangements by recalling securities.

Of course, if the institution's interest is large enough that it could influence the ultimate outcome of the vote, then the institution may feel that it is worse off in terms of its investment if the result of the vote is different than it would have been had it been able to cast its vote. If the borrower of the security exercises the votes and does so differently than the institution would have done, the result of the shareholder vote may be the opposite of what the institution would have wished it to be. If the borrower does not vote at all, the vote results may be skewed to give more apparent weight to the votes of those whose views differ from the institutional investors than would have been the case had the institution been in a position to exercise its vote. In either case, the result of the vote will not reflect the full weight of the institution's views on a particular matter and, accordingly, neither the issuer nor the marketplace has a clear view of investor sentiment with respect to the particular matter.

As discussed in 37.1 the terms of the lending arrangement may be cast to allow the lender to have the shares returned to it so that a lender may vote. While this solves the problem in some situations, there are a number of reasons why it is not a complete answer for institutional investors who wish to take advantage of a share's revenue-generating potential without sacrificing their right to vote. There is some administrative cost, both in terms of keeping track of record dates and in ensuring that the share comes back. In some cases, it is very difficult, if not impossible, to get the shares back in time. Where it is possible from a timing perspective, the borrower may not be able to deliver the shares in time (if, for example, circumstances require the

[442] There may be other situations in which casting a vote is not in the investor's interest For example, where the investor holds only a small position (and its vote will have little if any impact), the costs associated with casting the vote may outweigh any benefit to the beneficiaries.

borrower to go into the market to acquire the shares to be delivered to the lender). A more practical solution is for institutional investors to consider the ICGN solution discussed in Section 43.4.4 and agree that they will not vote a position that they hold as borrower. They may also try to impose this requirement on others over whom they may have some influence. This will, of course, not solve empty voting problems in their entirety, but it will be a start.

45.1.3 Reliance of Institutional Investors on Third-Party Advisors

Institutional investors are able to exert significant influence on the issuers in which they invest. Some of Canada's largest institutional investors, including CPP, Teachers', BCIMC and the Caisse publish their own proxy voting guidelines and dedicate considerable resources to reviewing and analyzing proxy materials before casting their votes.

Other institutional investors find it helpful and cost-effective to hire a proxy advisory firm to help them with many aspects of the process, including analysis, policy implementation, ballot reconciliation (to ensure all the votes they are supposed to vote are delivered), vote delivery, reporting and disclosure. The various statements of principle referred to above do not take issue with practice, provided the institution is not relying blindly on the proxy advisory firm – essentially abdicating decision making to that proxy advisory firm.[443] The issues associated with reliance on proxy advisory firms is discussed in Section 44.2 of this paper.

45.1.4 What Needs to Be Done?

The quality of the shareholder vote depends in part on the willingness of investors to cast their votes. The focus that the institutional investor community has placed on institutions casting their votes on an informed basis is therefore important to the quality of the vote.

In our view, institutional investors can make several additional contributions to the effectiveness of the proxy voting system. The first is to consider whether there are actions that institutions take that compromise the effectiveness of the system, even inadvertently. For example, if it were evident that securities lending programs in which institutions participated encouraged empty voting (because the borrower was only borrowing the shares to vote), it may be appropriate for institutional investors to consider the terms of their lending arrangements to prevent this result to the extent possible.

Institutional shareholders can also play a key role in addressing the tensions between the issuer community and proxy advisory firms, by engaging with the proxy advisory firms in a way that would promote better accountability.

Finally, it is important that institutional investors play a major role in addressing any deficiencies in the proxy voting system that compromise the quality of the shareholder voting. This can be

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443 The NYSE Corporate Governance Report, *supra* note 40, states:

> The Commission also recognizes the need that some institutional investors have to use third party proxy advisory services, and while this decision should generally be left to the discretion of the institution, the Commission believes that such a decision does not relieve institutions from discharging their responsibility to vote constructively, thoughtfully and in alignment with the interests of their clients.

done in a variety of ways, including through position papers, engagement with the intermediary community and representations to securities regulators. We look forward to receiving comments from institutional investors on this paper.

45.2 Retail Investors

45.2.1 Encouraging Retail Shareholders to Vote

Retail investors vote their own shares, generally without the benefit of proxy advisory firms or proxy voting guidelines. The percentage of retail investors that vote is typically quite low. Engaging proxy solicitors to bring in the retail vote can be prohibitively expensive.[444] We have described below some possible steps to increase voting participation on the part of retail investors. The steps raised by the SEC in its concept release should be considered in the Canadian context to determine whether the likely result would justify any cost involved.

45.2.2 Options Proposed in SEC Concept Release

The SEC Concept Release canvasses a number of possible steps that could be taken to encourage retail investor participation in the proxy voting process, including more accessible disclosure, investor education, enhanced issuers and brokers' Internet platforms, inexpensive or free proxy voting platforms that would provide retail investors with access to proxy research, vote recommendations and vote education.

Another possibility canvassed by the SEC in this release is "client-directed voting". Brokers and other intermediaries would solicit voting instructions from retail investors on specific topics (such as the election of directors). The investor could, for example, specify that their vote should always be cast in favour of the board's recommendations. These instructions would be applied to all of the investor's VIFs, unless the investor changed those instructions. In connection with any meeting, the investor would receive a VIF that was pre-marked in accordance with their voting instructions, together with the rest of the meeting materials. Unless the investor otherwise instructs their broker, the broker would vote that investor's shares in accordance with the advance voting instructions as pre-marked on the VIF.[445]

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444 In the 2010 proxy season, Prudential offered investors an incentive to vote. Every shareholder who voted was entitled to select a gift from Prudential - a tote bag made of recycled organic cotton or have a tree planted in their honour. Prudential, "The company is offering eco-friendly gifts to registered shareholders who vote" (2010), online: <http://www.news.prudential.com/article_print.cfm?article_id=5656>.

445 SEC Concept Paper, *supra* note 30, section IV B.

46 Engagement of the Canadian Regulators

46.1 The Evolution of the Regulation

46.1.1 Purpose of the Regulation

The CSA has been regulating the communication flow between issuers and investors since 1987, when they first introduced NP 41. There has been a subtle shift in the purpose of regulation over the years. One of the three objectives of NP 41 was to "…ensure the non-registered holders have the same access to corporate information and voting rights as registered holders".[446] The Companion Policy to the current NI 54-101 states that one of the fundamental principles underlying the instrument is that "all securityholders of a reporting issuer, whether registered holders or beneficial owners, should have the opportunity to be treated alike as far as is practicable." In the amendments proposed to that instrument in [May] 2010, the CSA notes that those amendments "kept in mind" this fundamental principle, but also notes that the purpose of NI 54-101 is to "give beneficial owners who hold their securities through intermediaries or nominees a reasonable opportunity to exercise the voting rights attached to those securities". And so the CSA has moved from "ensuring" that non-registered investors are treated the same as registered investors, to a fundamental principle that they have the opportunity to be treated alike "as far as is practicable", to simply as "reasonable opportunity" to exercise their voting rights.

46.1.2 OBO/NOBO Status

The idea that investors could choose not to allow issuers to know that they were investors was first introduced into Canadian law in 1987 in NP 41. It did not use the terms "OBO" and "NOBO", but it required intermediaries to seek instructions from their clients about whether their clients wished to have their identity disclosed to the issuers in which they had invested. When one compares the current NI 54-101 and the Proposed Amendments to NP 41, several interesting differences are apparent.

First, as noted in Section 8.2, NP 41 provided for investors to default to having their identity revealed to the issuer if they did not specify on their account opening form whether they wished this to be the case or not. Interestingly, some commentators in the United States are currently advocating that investors default to NOBO status if they do not specify a preference, in part because they do not believe that many investors actually understand or have a reasoned preference for OBO status.

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[446] The other two objectives were to "…ensure that the obligations of each participant in the communication chain are equitable and clearly defined:" and to "…ensure that regulation and procedure is uniform nationwide".

Second, NP 41 required intermediaries to advise their clients annually in writing of their current instructions regarding the exercise of voting rights and the forwarding of materials and to advise their clients that their instructions could be varied by providing written notice to the intermediary.[447] When NI 54-101 came into force in 2002, this provision was eliminated and replaced with a provision simply allowing clients to change the instructions to its intermediary at any time.[448]

46.2 Are the Regulators Engaged at the Appropriate Levels?

In our view, Canadian regulators are not sufficiently engaged in regulation or oversight of the proxy voting system. The uncertainty that exists in the marketplace regarding the reliability of the proxy voting system is enough to justify more regulatory interest.

It is really just the CSA that regulates the proxy voting system and this may be appropriate. There is currently no role played by the IIROC (which is responsible for overseeing all investment dealers and trading activity on debt and equity marketplaces in Canada) or the TSX or TSXV or their parent company TMX Group, which also operates other markets and offers a number of other services, including clearing facilities and data products.

There is not enough accountability otherwise built into the system to compensate for the lack of regulatory oversight. Investors do not have any standing to require an accounting of the way in which materials and votes have been handled. Issuers may look to their contractual relationship with their transfer agents to require an accounting for the way in which the communication process has been handled. However, this is incomplete since at least half of the issuer's investors are likely to be OBOs

The securities regulatory regime relating to the proxy voting system is flawed in a number of ways. It addresses some aspects of the system and it does follow through on other aspects, such as whether votes and voting instructions have been properly tabulated. Moreover, it does not deal with certain issues that are at the heart of the system's ineffectiveness, such as securities lending.

The recent proposals to amend the regulations relating to proxy voting will do little to improve the system. The real focus of those amendments has been on creating a notice-and-access regime. As we discuss elsewhere in this paper, notice-and-access will make an important contribution to reducing reliance on paper in the system. The Proposed Amendments, if they are adopted, will improve the system in a number of other important ways (see discussion in Section 26.3.)

However, the Proposed Amendments do not extend the reach of the securities regulators into aspects of the proxy voting system that they have not historically regulated, but which contribute to the overall weakness of the system. For example, they do not address over-voting or issues relating to tabulation.

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447 Alternatively, intermediaries could mail the relevant forms to their clients annually. NP 41, part V, section II(7).

448 NI 54-101.

In our view, one of the most problematic aspects of the Proposed Amendments that they demonstrate regulatory prejudice for treating NOBOs as much like OBOs as possible, rather than treating them as nearly as possible like registered shareholders. In our view, this abandons the original regulatory purpose behind the instruments such as NI 54-101 and suggests that the regulators have been persuaded by the intermediaries and by Broadridge, who have an interest in investors becoming OBOS rather than NOBOs.

46.3 What Needs to Be Done

We have already discussed certain steps that the securities regulators need to take in order move closer to creating an effective proxy voting system.

46.3.1 Establish a Task Force

The regulators should set up a task force comprised of individuals who are knowledgeable about the system, but who do not have any current stake in the system. The mandate of the task force should be to conduct a detailed examination of the operation of the proxy voting system and then determine whether the proxy voting system is effective. The task force should produce detailed recommendations about steps that need to be taken to remedy any deficiencies in the system and should, to the extent possible, set timelines for progress in that regard.

46.3.2 The Argument for Regulation of Third-Party Service Providers

Most of the participants in the proxy voting system are regulated to some extent at least as market participants under Canadian securities regulation. The fact that a participant in the proxy voting system falls under the umbrella of some regulatory authority does not, of course, mean that they are being regulated in a manner that is meaningful for the proxy voting system. It does, however, mean it is has some form of accountability and authority with a public policy mandate. This creates at least the possibility that a regulator, most likely the securities regulatory authorities, may have the standing to bring all parties together to find a solution to the challenges faced by the proxy voting system in the interests of the capital markets more generally.

In our view, the regulators should make proxy agents market participants and determine what type of regulation should apply to them. We recognize that many of the functions performed by proxy agents (primarily Broadridge) are regulated, to the extent that the functions are those imposed on the intermediaries under NI 54-101. However, the role performed by proxy agents such as Broadridge means that they play a significant role in establishing operating practices. In order to correct the problems with the system, securities regulators must be in a position to require Broadridge and other proxy agents to adhere to certain standards. In addition, Broadridge and other proxy agents have a universe of information about the proxy voting system that is only available to them, but is important in understanding the system and the problems that have developed. Regulators must be in a position to require proxy agents to provide information to them in a form that is most useful to the regulators.

We are less certain of the need to regulate proxy advisors. One the one hand, if proxy advisors had some type of accountability to the regulators, issuers would have recourse for problems that may arise with the quality and accuracy of the advisor's research and recommendations. There may also be reason for the regulators to consider conflicts of interest that exist within the business model of any proxy advisor. On the other hand, it seems to us that the proxy advisors are simply providing their view on voting matters to their clients and that this is not an activity that is otherwise regulated in Canada. We are not at all sure that it should be. This area requires more input from both issuers and investors as well as from the proxy advisory firms.

47 In Conclusion

We believe that an effective proxy voting system is a worthwhile and achievable goal. We also believe that those involved with the proxy voting system recognize that there are difficult issues that should be addressed and that they are committed to finding a path through to a solution.

GLOSSARY

AMF the Autorité des marchés financiers (or AMF), the securities regulator in the province of Quebec.

beneficial determination date the date established by an issuer of securities for determining the holders entitled to vote at a meeting.

beneficial list the list of beneficial shareholders of an issuer.

beneficial shareholder the person who enjoys the benefit of the ownership of a share despite the fact that legal title is registered in the name of another person or entity (see "Registered Owner").

book-based system a trading and clearance system in which securities are traded between brokers and other financial institutions within a common depository (in Canada, CDS). The securities in the book-based system are represented by a global certificate which is held at the depository.

book-entry only (BEO) system a system that provides exclusively for securities to be held in the book-based system, i.e., all securities must be registered in the name of the depository.

Broadridge a US public company whose operations in Canada are classified into three business segments: Investor Communication Solutions, Securities Processing Solutions, and Clearing and Outsourcing Solutions.

broker-dealer a company or other institution that trades securities for its own account or for the account of others. Broker-dealers must be registered under provincial securities laws.

call option an option to buy an asset or security.

CBCA the *Canada Business Corporations Act*.

CCGG the Canadian Coalition for Good Governance, an organization comprised of over 41 institutional investors, with the objective of promoting good governance practices in the companies in which its members invest.

CDS CDS Ltd and CDS Clearing and Depository Services Inc., in their collective capacity, the only recognized depository in Canada.

CDS participant those brokers who are participants in the CDS book-based system. There are approximately 100 CDS participants.

CDSX a comprehensive electronic securities and payment management system that was rolled out in October of 2003. CDSX electronically manages payment and settlement of both equity and debt securities.

Cede & Co the nominee for the Depository Trust Company.

certificate of mailing a certificate filed on SEDAR evidencing the mailing of proxy materials to the registered holders of an issuer.

Code the Securities Lending Code of Best Practice prepared by the International Corporate Governance Network with a view to clarifying the responsibilities of all parties engaged in stock lending.

convertible debentures debentures that are convertible into another security (usually common shares) of an issuer at a prescribed conversion price.

CSA the Canadian Securities Administrators, a voluntary umbrella organization of Canada's provincial and territorial securities regulators whose objective is to improve, coordinate and harmonize regulation of the Canadian capital markets.

CUSIP the Committee on Uniform Securities Identification Procedures. The CUSIP system—owned by the American Bankers Association and operated by Standard & Poor's—facilitates the clearing and settlement process of securities. **[Source SEC]**

CUSIP number a CUSIP number is an alphanumeric code used to identify most securities including stocks and bonds of all registered US and Canadian companies. **[Source SEC]**

custodian organizations that provide custodial services to institutional investors and pension funds, in connection with which they carry out the administrative functions associated with the shares in their custody, such as making sure dividends are received, keeping track of meeting dates, and ensuring that their clients receive voting materials.

dematerialization a term that refers to the elimination of physical share certificates.

derivative a contract, financial instrument or security that derives its value from something else, such as an underlying asset, reference price, interest rate or index. Two of the simplest examples of derivatives are options and futures.

dissident persons other than management who solicit proxies.

dividend reinvestment plan a plan that can be opted into by investors whereby dividends that they are entitled to receive on their shares are automatically reinvested in additional shares of the issuer.

DTC the Depository Trust Company, a subsidiary of the Depository Trust & Clearing Corporation, the depository for securities in the U.S.

empty voting when an investor has the right to vote, but has reduced or eliminated its economic exposure to the security being voted.

forward contract an agreement to buy or sell a security, commodity or other product at a pre-determined price on a future date.

FTP file transfer protocol.

futures refers to a futures contract which is an agreement to sell a specific commodity or financial instrument at an agreed price on a future specified date.

global certificate or **jumbo certificate** a single share certificate representing all (or a majority) of all issued and outstanding shares of the issuer. The certificate is registered in the name of CDS and the beneficial title to the shares represented by the global certificate is allocated amongst the various beneficial shareholders.

hedge an investment intended to reduce or offset the risk of price fluctuations in an asset.

hedge fund a managed fund open to a limited number of investors that uses a variety of investment strategies (e.g. long and short positions, derivatives and leverage) to achieve returns.

ICGN the International Corporate Governance Network, a not-for-profit body founded in 1995 with a mission to raise standards of corporate governance worldwide. The International Corporate Governance Network ("ICGN"), a global membership organization of 450 leaders in corporate governance in 45 countries, with institutional investors representing assets under management of around US$9.5 trillion,[449]

IIAC the Investment Industry Association of Canada, a member-based, professional association that represents the interests of the investment industry as a whole.

IIROC the Investment Industry Regulatory Organization of Canada, the national self-regulatory organization which oversees all investment dealers and trading activity on debt and equity marketplaces in Canada.

indirect ownership where investors do not take legal ownership of shares in which they invest, but instead acquire an entitlement to the benefits associated with those shares such as the right to vote and the right to receive dividends.

information circular a document sent to shareholders which describes in detail the matters to be voted upon at an annual or special meeting of shareholders.

insider generally means any of: (a) a director or officer of a reporting issuer; (b) a director or officer of a person or company that is itself an insider or subsidiary of a reporting issuer; or (c) an individual who has beneficial ownership (or a combination of beneficial ownership and control or direction) over shares of a reporting issuer carrying more than 10 percent of the voting rights attached to all outstanding voting shares of the issuer.

institutional investors organizations that pool significant sums of money from various investors and make large investments on behalf of those investors. Institutional investors include pension funds, mutual funds and insurance companies.

intermediary anyone who holds shares on behalf of someone else.

issuer a corporation or other entity that issues securities.

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449 See ICGN, online: <http://www.icgn.org/about/>.

JASDEC Japan Securities Depository Center, Inc., Japan's central securities depository.

legal proxy a legal voting power of attorney, in the form of Form 54-101F8 of NI 54-101, granted to a beneficial owner or to a person designated by the beneficial owner by either an intermediary or a reporting issuer under a written request from the beneficial owner.

majority voting a policy whereby if more than a majority of the votes cast for the election of a director are "withhold" votes, the director is required to tender his/her resignation.

margin account an account that permits investors to borrow money to make investments in securities. Interest is charged on the borrowed amount and the securities purchased are used as collateral for the loan.

market maker a firm that stands ready to buy and sell a particular security on a regular and continuous basis at a publicly quoted price.

market participant the various entities that play a role in the securities markets and are regulated by applicable securities laws. They include, issuers, CDS, the brokers and the transfer agents.

mini omnibus proxies proxies that are provided by an intermediary who is a CDS participant (and who is therefore named as a proxy holder in the omnibus proxy) to one of its clients who is also an intermediary.

multiple proxy the form received from the transfer agent listing all of the intermediaries and the number of votes represented by the proxies they hold.

mutual funds professionally managed pooled funds that invest money on behalf of multiple investors. Mutual funds are regulated by provincial securities laws.

non-clearing intermediary those intermediaries who do not themselves hold their clients' positions, but rather have their clients' positions held through proximate intermediaries.

negative voting when votes are cast by someone having an interest that is adverse to the issuer's interest.

NI 51-102 National Instrument 51-102 – *Continuous Disclosure Obligations*.

NI 54-101 National Instrument 54-101 – *Proxy Solicitation*.

NOBOs means non-objecting beneficial owners, i.e. beneficial owners of shares who do not object to their identity being disclosed to the issuer.

nominee someone designated to act for another in a representative capacity for a limited purpose.

non-registered holder a shareholder who is not listed as a registered shareholder on the books of the issuer.

notice-and-access model of electronic delivery a process that provides an issuer soliciting proxies with an alternative delivery method whereby the issuer posts the proxy materials on an Internet website (access) and advises the shareholders of the presence and location of the proxy materials and how to access them (notice).

NP 11-201 National Policy 11-201 – *Delivery of Documents by Electronic Means*.

NRD the National Registration Database, an initiative of the CSA and the IIROC, is a web-based system that will permit dealers and advisers to file registration forms electronically.

NYSE the New York Stock Exchange.

NYSE Rule 452 means Rule no. 452 of the NYSE dealing with the giving of proxies by NYSE member organizations.

OBOs objecting Beneficial Owners, i.e., beneficial owners of shares who object to their identity being disclosed to the issuer.

omnibus proxy a proxy sent by CDS to the issuer, which shows that CDS has given its proxy to each of the participants for the number of shares shown for that participant on the CDS list.

option a right to buy or sell an asset at a pre-determined price within a prescribed time period.

OSA the *Securities Act* (Ontario), R.S.O. 1990, c. C-5, as amended.

OSC the Ontario Securities Commission, the securities regulator in the province of Ontario.

over-reporting where the vote attributable to a specified number of shares is reported more than one time (usually as a result of a share-lending).

over-voting the situation that materializes where votes cast for a particular position exceed the total number of shares represented by that share position.

overvoting subcommittee the subcommittee of the Industry Implementation and Monitoring Committee for National Policy Statement No. 41, which reported in a memorandum from Robert F. Kohn (Solicitor, Capital Markets) to the CSA dated October 5, 1995.

paper-based trading system the share-based system in which investors take physical ownership of shares, evidenced by a share certificate in their name.

participating brokers the approximately 100 brokers who participate in the CDS system.

pension fund a fund that collects and invests contributions to a pension plan for the exclusive purpose of financing pension benefits for the contributors.

primary market the market for new issues of securities (as distinguished from the secondary market where previously issued securities can be traded).

prospectus a legal document that must be provided to investors contemplating an acquisition of securities in a public offering. It provides full true and plain disclosure of all material facts pertaining to the issuing company.

proximate intermediaries brokers who are CDS participants and brokers who hold their interest in registered form.

proxy a grant if authority by a shareholder to transfer its voting rights to another person.

proxy advisory firms a company hired by shareholders (generally institutional) to cast votes on their behalf based on a specified guidelines prepared by the advisory firm. The most prominent proxy advisory firms are RiskMetrics and Glass Lewis.

proxy materials materials provided to shareholders in connection with a shareholder meeting (including the management information circular, form of proxy, VIF (where applicable) and notice of meeting.

proxy solicitation firm a private firm that is engaged to assist with the solicitation of proxies.

put option a right to sell a specified number of securities at a stated price before a specified time.

quorum the minimum number of shares that must be represented in person or by proxy at a meeting in order to conduct business.

record date capture the practice of borrowing shares immediately prior to a record date in order to be entitled to vote the shares and then returning those shares to the lender immediately after the record date.

registered shareholder the shareholder whose name appears on the register of the issuer. Where there is a book-entry only system, the sole registered shareholder will be CDS.

retail investor an investor who holds security interests (either as a registered holder or beneficial owner) for its own account.

SEC the Securities and Exchange Commission, a division of the US federal government that is the principal regulator for financial markets in the United States.

SEC Concept Release Securities and Exchange Commission, Release No. 34-62495, "Concept Release on the US Proxy System" (14 July 2010).

secondary market a market where previously issued securities can be traded.

securities borrower the borrower in a securities lending transaction and is generally a person who needs to have a position in a security for a period of time for reasons other than making an investment in that security.

securities lender the lender in a securities-lending transaction and is generally an investor or an intermediary who has a position in a particular security which it expects to continue to hold throughout the term of the loan.

securities lending transaction a transaction whereby an investor or an intermediary transfers its interest in publicly traded shares to the borrower in return for an agreement by the borrower to return an equivalent interest at some point in the future together with a fee.

security entitlement term used in the STA to describe the proprietary interests of an investor in a security held through an intermediary.

SEDAR the System for Electronic Document Analysis and Retrieval, a system that provides public access to most statutorily required disclosure documents filed by public companies and investment funds with the Canadian Securities Administrators

SEDI the System for Electronic Disclosure by Insiders, Canada's online, browser-based service for the filing and viewing of insider reports.

shareholder proposal a process governed by corporate law whereby a shareholder of an issuer can require that an issue be put to the vote of shareholders at a shareholder meeting. The rules governing shareholder proposals are prescribed by corporate law.

shareholder register a list kept by an issuer of the registered holders of its shares.

shareholder rights plan a form of take-over bid defense whereby rights are granted to shareholders of a corporation which permit shareholders to acquire shares of the corporation at a deep discount to the market price in the event that a person or company acquires more than a specified percentage of outstanding shares (usually 20 percent). Rights granted to the party that acquires more than the specified percentage under the plan are null and void resulting in significant dilution to the interest of the acquirer in the event that the rights plan is triggered.

short sale sale of a security that an investor has borrowed (but does not own) on the expectation that the value of the security will drop, at which time, the security can be purchased in the market to repay the loan.

skewed voting where the holder of the right to vote does not appear to have the same incentives with respect to the issuer as traditionally attributed to longer-term beneficial holders of shares.

SRO a self-regulatory organization.

STA the *Securities Transfer Act* (Ontario), S.O. 2006, c. 8, proclaimed in force January 1, 2007.

STAC the Securities Transfer Association of Canada, a non-profit association of Canadian transfer agents.

STAC Proxy Protocol a protocol prepared at the request of and for use by members of the STAC to provide guidance to people appointed to review and tabulate proxies for meetings of

security holders of a corporation incorporated under the *Business Corporations Act* (Ontario), the *Canada Business Corporations Act* or other similar statutes.

stock option an option to acquire a share at a prescribed price known as the "strike price".

TSX/S&P Index – TSX/S&P Composite Indes

T+3 shorthand for "trade plus three days" and refers to the fact that investors must complete or "settle" their security transactions within three business days of the trade.

tabulator the party responsible for counting the votes at a shareholder meeting and reporting the count to the meeting chair.

total return swap a swap in which one party receives the gain on the price of a security while paying the counterparty for any reduction in the price of such security.

transfer agent an organization that maintains the records of, and tracks the ownership of securities for, a reporting issuer.

TSX the Toronto Stock Exchange.

TSX rules refers to the TSX Handbook and other rules promulgated by the TSX which govern the rights and obligations of issuers listed on the TSX.

TSX Venture the TSX Venture Exchange, a stock exchange which serves the public venture capital market and lists securities of early stage issuers seeking growth capital who may not meet all of the listing requirements of the TSX.

UMIRs the Universal Market Integrity Rules which regulate various trading practices, including manipulative methods of trading, short selling, front running and best execution obligations.

underwriter a person or company who, as principal, agrees to purchase securities with a view to distribution or who, as agent, offers for sale or sells securities in connection with a distribution.

VIF voting instruction form.

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WARD
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