Canadian Coalition for
GOOD GOVERNANCE

THE VOICE OF THE SHAREHOLDER

July 12, 2013

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Nunavut

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Dear Sir/Madame:

Re: Canadian Securities Administrators ("CSA") Proposed National Instrument 62-105 *Security Holder Rights Plan*; Proposed Companion Policy 62-105CP *Security Holder Rights Plans* (the "CSA Proposal") and the Autorité des marchés financiers ("AMF") Consultation Paper *An Alternative Approach to Securities Regulators' Intervention in Defensive Tactics* (the "AMF Proposal")

We have reviewed the CSA Proposal and the AMF Proposal (collectively, the "Proposals"), both released on March 14, 2013, and we thank you for the opportunity to provide our comments, which are set out below.

CCGG's members are Canadian institutional investors that together manage approximately $2 trillion in assets on behalf of pension funds, mutual fund unit holders, and other institutional and individual investors. CCGG promotes good governance practices in Canadian public companies and the improvement of the regulatory environment to best align the interests of boards and management with those of their shareholders and to promote the efficiency and effectiveness of the Canadian capital markets. A list of our members is attached to this submission.

Overview

We have considered the Proposals and are of the view that the approach of the CSA Proposal is preferable to that of the AMF Proposal, for the reasons discussed below. However, we believe that there are significant unresolved structural issues in the Canadian regulatory framework that have implications for both Proposals and that these need to be addressed before either proposal can be meaningfully implemented. Accordingly, we encourage the CSA and AMF to work together with other capital market participants to ensure:

- A proxy voting system that protects the integrity of the shareholder vote
- Effective shareholder democracy

The efficacy of both Proposals relies to a significant degree on the assumption of the integrity of the shareholder vote and effective shareholder democracy being in place. Under the CSA Proposal, for example, shareholder approval or rejection of a shareholder rights plans determines ultimately whether hostile bids can go forward. Without the proper infrastructure in place there can be no assurance for the participants (target issuers, bidders and shareholders) that votes have been properly counted or that hidden ownership and empty voting are not affecting the outcome.

Similarly, the AMF Proposal relies on the ability of shareholders unhappy with the board's defensive actions in the face of a hostile bid to oust the board in order to replace it with a board more open to the bid. Without effective majority voting and other elements of shareholder democracy, shareholders cannot remove directors as they see fit, leaving the courts as the only option if they wish to challenge a board. It is important to note that while many of the largest Canadian companies may have adopted majority voting policies and have strong independent nomination processes in place so that shareholder democracy for them is arguably closer to a reality, this is not the case for the majority of Canadian companies and accordingly regulators should be wary of adopting rules that do not reflect the reality for most issuers.[1]

The AMF Proposal

The AMF Proposal gives boards the ability to adopt takeover bid defences, without shareholder approval, that could prevent shareholders from tendering to bids the board views as unacceptable, making directors the ultimate arbiters of which bids will go forward. The only recourse for shareholders wishing to tender to a hostile bid may be to remove the directors and replace them with directors friendly to the bid or to go to court to challenge the directors on the basis of a breach of fiduciary duty or oppression. We find this approach to be unacceptable for the following reasons.

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[1] Even boards of the larger Composite Index companies with generally good governance practices can sometimes appear to act in self-serving ways. For example, witness the recent "vote buying" of Agrium's board where during a proxy contest this year Agrium's directors approved the use of the company's cash to pay investment advisors if their clients voted in favour of the incumbent directors but not if the votes were in favour of the dissident's slate of board nominees. While the quality of directors in Canada appears to be generally rising, regulation should not assume that directors will always act appropriately.

1. The Decision to accept a bid should belong to shareholders

The decision whether to sell shares in the context of a hostile bid should belong ultimately to shareholders and not directors. Corporate law is clear that directors have authority in other change of control situations: arrangements and amalgamations, for example, must be approved by the board before they can go to shareholders for approval. Some argue that this supports the view that similar authority should be extended to directors in a hostile bid situation and that it is appropriate that directors be able to adopt defensive tactics that leave them with the discretion, exercised in accordance with their fiduciary duty, as to whether it is in the best interests of the corporation to be sold. However, it is our view that the opposite should be inferred from the fact that corporate law does not explicitly provide for director authority in a hostile bid context while it does in other contexts. There are good reasons to hold that the hostile bid context is unique (see following item).

2. Directors are in a potential conflict of interest in a hostile takeover bid situation

As is widely recognized by courts and regulators, directors and management are in a potential conflict of interest position in hostile bid situations.[2] While the conflict for directors may not be as stark as that for management, it still exists. This is an important reality that should not be ignored in the discussion of who should determine whether a bid is acceptable. Of course directors have a fiduciary obligation to act in the best interests of the corporation but there is no need to rely on that duty in a bid scenario when shareholders are best able to decide what to do with their property. We do not agree that shareholders are not in a position to make that decision due to a lack of information (see following item). The AMF Proposal would attempt to manage the potential conflict of interest through processes such as the use of special committees and independent advisors but the preferable route is to circumvent the potential conflict altogether.

3. Directors are not without power and influence in the face of hostile bids

Directors are not powerless in the face of hostile bids when they lack the ability to adopt defensive tactics without shareholder approval. Their expertise and superior knowledge of the company are not without impact. Directors can communicate their views to shareholders on the merits of the bid and explain why they believe the bid undervalues the company, including arguments as to their long term vision or plans for the company which the bid would undercut. They also may use the company resources, which management and the board control, to do so. Directors also can reach out to shareholders individually to convince them of the rightness of the board's position (as they should be doing regularly even outside the context of a hostile bid). Shareholders should be free to consider and accept or reject those arguments and are capable of doing so. We saw two examples recently of shareholders doing exactly that in the context of a proxy contest, with different outcomes: in CP shareholders decided that they did not accept the board's arguments while in Agrium shareholders decided that they did. The board also has an advantage because the majority of shareholders typically are inclined to go along with the recommendations of management and the board. In the end, directors have significant power to influence the outcome of a hostile bid. Studies showing that a majority of

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[2] See AMF proposal: "[NP 62-202] is meant to address the over-arching concern that the interests of boards and management of targets may not be aligned with those of security holders and that boards and management may implement defensive tactics that deny security holders the right to respond to a bid". In Unocal (Unocal 954-55; Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 950 (Del. 1985)), the court recognized "the omnipresent specter that a board may be acting primarily in its own interests" in a hostile takeover bid context.

hostile bids end with a sale of the target company are not evidence that boards have too little power but may simply reflect the fact that shareholders have not accepted directors' views.

4. Letting shareholders decide whether to tender to a bid is not inconsistent with the BCE decision

BCE established that directors' fiduciary duty requires that they look to what is in the best interests of the corporation, not only of shareholders, and in determining 'best interests' directors may look to the interests of, *inter alia,* shareholders, employees, creditors, consumer, governments and the environment. If a matter falls under the directors' jurisdiction, they may consider a broader range of interests than just short term profit or share value.

However, shareholders are under no similar obligation nor should they be. When a matter falls under shareholders' jurisdiction, as we believe the right to sell shares into a bid does, then shareholders are free to make a decision based on what they determine to be in their own best interests, whether that is based on a short term or long term perspective. This by no means entails, however, that a short term view will prevail or that factors other than share price premium will be ignored. For our members, and many other shareholders, a long term focus is appropriate a significant majority of the time and the best interests of their beneficiaries or clients include a consideration of more than short term share price (and leaves room, for example, for the view that long term sustainability considerations are important to the value of their investment). Leaving the decision in the hands of shareholders does not mean that the short term perspective will necessarily rule the day. There is no empirical data, as far as we are aware, that shows that arbitrageurs and hedge funds determine the outcome of hostile bids (even though there is evidence that such players do become involved after the announcement of a bid). Policy decisions should be based on empirical rather than anecdotal evidence.

5. Lack of judicial securities infrastructure in Canada

The AMF Proposal ultimately relies on shareholders or bidders challenging directors' decisions in court, as is the case in the U.S. However, in Canada, the expertise in takeover bid situations currently resides with provincial securities regulators. Shareholders looking to find recourse in the courts in Canada will not necessarily have access to the same sophisticated or timely analyses that has developed over the years in the U.S. (especially in Delaware). While some provinces do have a commercial list with sufficient expertise this is not the case across the country with the result that we do not have the judicial infrastructure in place to support the AMF Proposal. In conjunction with the judicial deference shown to directors under the business judgment rule, allowing courts to determine these issues may result in directors' decisions being, for all practical purposes, unchallengeable.

The CSA Proposal

We support the approach of the CSA Proposal as the better alternative for the reasons outlined below. However, we also see certain problems with that proposal that we believe should be addressed and we outline those below as well.

Positive features of the CSA Proposal

Recognizes the primacy of shareholders over directors in the takeover bid context

By requiring that shareholders rights plans be approved by shareholder within 90 days of their adoption, and requiring annual approval thereafter, the CSA Proposal in principle gives shareholders the authority to decide whether they want to allow directors this form of takeover defense and thus whether a bid should

go directly to shareholders. Directors should not be able to use shareholder rights plans to interfere unilaterally with the market for control in order to entrench themselves or management and the CSA Proposal recognizes this principle.

Strikes appropriate balance between targets and bidders

Both Proposals accept the view that the current takeover bid regime is too bidder friendly. Many people also argue that it gives target issuers no option but to sell, leading to a 'hollowing out' of corporate Canada (this is based on the assumption that most bidders are foreign controlled). [3] We note that the first of these propositions is not supported by empirical evidence and, in fact, some studies show that under the current regime it is the shareholders of the target company that enjoy the increase in value rather than the bidders' shareholders.[4] The second proposition, even if true, does not establish that the tendency of targets to be sold once a bid has been made rather than remain independent is, in fact, a bad thing. It is commonly understood that target companies tend to be underperformers and that the market for corporate control functions as one of the most effective disciplines on management. It may be better for shareholders generally that targets tend to be sold.[5]

It is CCGG's view that the CSA Proposal strikes an acceptable balance between target and bidder companies in that it provides shareholders with a defensive tactic that they can keep in place indefinitely if they so choose and at the same time allows the bidder to go ahead with its bid if it can convince shareholders that the rights plan should be removed and their shares tendered into the bid. As discussed above, we believe that the decision is one for target shareholders to make and not directors. The CSA Proposal does enable shareholders to empower the board to defend against a bid indefinitely if the shareholders believe that is warranted. What it does not do is permit directors to prevent a bid from going to shareholders indefinitely if the directors believe that to be in the best interests of the corporation, as the AMF Proposal does.

Requires annual approval of shareholder rights plans

Requiring annual approval of rights plans will provide shareholders with the on-going ability to have input into what defensive tactics are in place at a particular time and stage of company development. This is important as circumstances, as well as the shareholder base, can change over relatively short time periods and what is at stake is significant enough to justify that it be addressed annually.

Provides shareholders with the ability to terminate a rights plan

The ability to terminate a rights plan, either by not renewing it at the annual meeting or at a meeting requisitioned by shareholders holding 5% of the outstanding shares, will provide shareholders with the opportunity to tender to a bid that the rights plan would otherwise deter, leaving the decision as to whether to accept a bid in the hands of shareholders, as CCGG believes it should be. We are aware of

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[3] Rights plans are a blunt instrument in that they apply to all bidders, Canadian and foreign. The argument that foreign takeovers are too prevalent or should be discouraged is a political one and should be addressed directly by government and not through the application of rights plans.

[4] Jeffrey MacIntosh, *Takeover Regulation in Canada*, Capital Markets Institute, June 7, 2013

[5] NP 62-202 opens with the statement that "The Canadian securities regulatory authorities recognize that take-over bids play an important role in the economy by acting as a discipline on corporate management and as a means of reallocating economic resources to their best uses." We are not aware of any arguments that this perspective is no longer valid.

concerns that shareholders with a short term perspective such as arbitrageurs and hedge funds may requisition a meeting to remove a rights plan in order to tender to a bid that directors feel is unacceptable but we believe this concern is unwarranted. In order for the rights plan to be terminated a majority of the votes cast must be in favour of the termination and there is no empirical evidence as far as we are aware to support the view that short term shareholders will constitute a majority of the voting shareholder base. If in fact they do, then they are entitled to remove the plan and tender to the bid for the reasons articulated above.

90 days is the appropriate time frame for shareholder rights plan approval

While recognizing that choosing a time period for which bids are to remain open is a somewhat arbitrary endeavour, we are of the view that if the CSA is to permit tactical rights plans, the 90 days set out in the CSA Proposal provides an acceptable balance between the current 45-60 or so days that regulators now permit pills to remain open and longer periods that may make it untenable for a bidder and thus discourage bids.

Concerns with the CSA Proposal

Potential abuse of tactical pills

We have some concern about the ability of boards to adopt a tactical pill in the face of a takeover bid when shareholders have already rejected the adoption of a rights plan at a shareholders' meeting. If the majority of shareholders have expressed the view that they wish to be open to receiving any and all bids, it is not clear why directors should have the ability to overrule that wish. The CSA Proposal will allow tactical pills to be in place for 90 days without shareholder approval. With this tactic available, directors may be encouraged not to seek shareholder approval for rights plans at annual meetings at all but simply adopt a pill when a bid emerges with no intention of putting it to shareholders.

Further, without the need for shareholder approval, the terms of such tactical rights plan may be very oppressive and not reflect the "new generation" of rights plans that have come to be accepted as 'shareholder friendly' and more consistent with good governance practices. And if securities regulators are no longer in the business of regulating bids, as the CSA has suggested, shareholders and bidders would have no recourse other than to the courts (and, as previously stated, there is a lack of a judicial securities infrastructure across Canada at present).

While we are sure that this is not the intention under the CSA Proposal, section 7(4) would appear to allow issuers to adopt a series of tactical rights plans in the face of a bid or bids without ever obtaining shareholder approval and we suggest that this issue be clarified.

Based on the foregoing, we recommend that the CSA Proposal be amended to prohibit the adoption of tactical pills if shareholders have voted at a shareholders meeting not to adopt a rights plan.

Should require rights plans to be 'permitted bid' 'new generation' rights plans

The impact of the ability to adopt tactical pills that can be effective for 90 days without shareholder approval will be that all bids will remain open for 90 days. If this is the case, arguably it would be appropriate for securities regulators to simply adopt such a rule and prohibit the adoption of rights plans altogether. However, we would not recommend this route because rights plans, in addition to increasing the time bids must be open to allow competing bids to emerge, can also serve the function of ensuring

equal treatment of shareholders in a change of control context and it would be unfortunate to lose this protection pills can afford.

However, not all rights plans provide this protection.[6] It is our view that the CSA should encourage the adoption of 'new generation' rights plans with "<shareholder friendly' attributes and discourage the adoption of rights plans with provisions that can entrench management and boards or unreasonably deter bids. Accordingly, we believe that the CSA should require that all rights plans contain the shareholder approval mechanism found in 'new generation' plans, namely, the requirement that 50% of shareholders must tender to the bid and, if that occurs, the bid must remain open for an additional ten days to allow other shareholders to tender their shares. This would remove the coercive aspect of bids, even with respect to partial bids, since shares tendered can be taken up pro rata after the "approval" of 50% of shareholders. It would also further help to protect shareholders from the "collective action" problem referenced in the CSA Proposal. This would also ensure that even tactical pills that are not presented to shareholders for approval would still be 'shareholder friendly'. Alternatively, the CSA could adopt that part of the AMF proposal that would require all bids to contain this shareholder approval mechanism.

Further, rights plans are complex documents that contain many detailed provisions that can result in unreasonably deterring bids and entrenching management and directors even with the 'shareholder approval' mechanism discussed above. (For example, many older style rights plans can be triggered by the right to vote shares or require that a bid be made for all outstanding shares.) For this reason, we would argue that in addition to incorporating a 'shareholder approval' mechanism, rights plans be required to be 'new generation' as that term is now understood and that the CSA establish rules on the terms rights plans must contain that reflect the current 'best practices' in rights plans.

In reality, the development of 'new generation' plans has been the result of proxy advisory firms, in particular ISS, policing the terms of these complex documents on behalf of their shareholder clients. According to ISS, the majority of plans that they review are not 'new generation' plans, which tend to be adopted only by larger companies with more advanced governance practices. Most of these old style plans are passed by shareholders. If the CSA were to establish regulations with respect to what provisions rights plans must have, it would level the playing field for all shareholders.

Managements and board votes should be able to vote on non-tactical shareholder rights plans

As a matter of shareholder democracy, we believe that management and directors should be able to vote with respect to the adoption of rights plans. However, given that boards and management are in an intrinsic potential conflict of interest with shareholders in hostile takeover bid situations, if the CSA, contrary to our recommendation, decides to allow for the adoption of tactical pills in that context, management and directors should not be eligible to vote on the adoption of or removal of such pills.

Securities regulators should not get out of the business of reviewing rights plans

We understand that part of the underlying motivation for the CSA Proposal is for securities regulators to get out of the business of regulating rights plans, which has historically been seen by many to be unsatisfactory due to inconsistent decisions and the mindset that 'the pill must go'. It is our view that it

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[6] According to our discussions with Debra Sisti, Head of Canadian Governance Research at ISS, the majority of the rights plans that they review are still 'old style' plans that serve to entrench board and management and unreasonably deter bids.

would be inappropriate for securities regulators to remove themselves and only become involved in rare situations for the following reasons:

- The only recourse for shareholders would be the courts and as discussed above, the necessary judicial infrastructure is not in place across Canada at this time. Frequently, courts can be more costly, move more slowly, may lack expertise in this area and are generally more deferential to directors than securities regulators. The courts also provide more limited basis for review than the public interest (e.g. oppression or breach of fiduciary duty).
- One of the main criticisms facing regulators' review of pills is inconsistent decisions across the country, but leaving decisions to the courts of different provinces will not remove this possibility.
- Inevitably, there will still be many circumstances where shareholders and/or bidders will need to avail themselves of an appeal to regulators. For example, as noted above, the majority of rights plans are not in the form of 'new generation' plans even though they have received shareholder approval. Under the CSA Proposal, the fact that these shareholder rights plans have been approved by shareholders would leave no recourse for bidders or shareholders in the face of onerous provisions. We believe that there is still a place for the regulators beyond only the extreme situations contemplated by the CSA Proposal.

While we think that securities regulators should continue to review rights plans, we believe that the other provisions of the CSA Proposal will mean that the regulators will be called upon to adjudicate in fewer instances.

It is true that the problem of inconsistent decisions among provincial regulators will remain but this points again to the need for a national securities regulatory regime of some sort and not to removing the securities regulators from the picture except for very limited circumstances.

Establish expert takeover panel

Since a national securities regulatory regime is unlikely in the short term, we propose as a solution to the problems of inconsistency and the need for expertise that Canada create an independent panel to deal with shareholder rights plans similar to the U.K.'s Panel on Takeovers and Mergers. The panel's function would be to administer the rules governing shareholder rights plan and thus could be involved in takeover situations where the target has adopted a rights plan. Such a panel could be comprised of representatives of securities regulators from across the country and other groups with significant expertise in takeovers bids (for example, in the UK, its panel is comprised of representatives from major financial and business institutions, as well as The Association of British Insurers, The National Association of Pension Funds, The British Bankers' Association, The Confederation of British Industry, The Association of Private Client Investment Managers and Stockbrokers, among others). We note that in the U.K. there is a negligible amount of litigation around takeover bids (a major difference from the U.S. situation) and that reviews of bids happen in 'real time', that is, quickly and efficiently – perhaps having a Canadian panel which deals with shareholder rights plans could lead to similar outcomes.

Provide guidance on "material" amendments

We agree with the CSA Proposal that material amendments should be treated in the same way as the adoption of a new rights plan and recommend that the CSA provide guidance on what would constitute a "material" amendment.

Require full disclosure of rights plans terms and amendments

We note the importance of regulators being vigilant about requiring comprehensive disclosure of all rights plans' terms and amendments to those terms. Rights plans are complex documents where much of the impact can be found in detailed and opaque wording and definitions. Under the CSA approach, shareholders have the responsibility of approving plans which will stay in place until they remove them. There will be no regulatory oversight of the fairness of the terms of those plans and it will be of utmost importance that shareholders understand the terms of the plans and their implications. We are cognizant of the fact that the current form of 'new generation' pill has evolved through the involvement of proxy advisory firms, in particular ISS, in making voting recommendations and we assume that this will continue. Shareholders will continue to rely in part on detailed analyses of rights plans by proxy advisors when deciding whether to vote in favour of a particular plan. In this context, we reiterate our concern that the use of tactical rights plans may mean that plans never go to shareholders for approval and thus their terms will never be scrutinized or analyzed by shareholders or their advisors.

Establish a minimum time period within which a shareholder meeting must be held

The timing of shareholder requisitioned meetings will take on greater significance under the CSA Proposal. The absence of a minimum prescribed time frame would likely result in more proxy contests and litigation with respect to the timing of meetings and create more risks for inconsistent regulatory decisions. Accordingly, we believe that the CSA should establish a 90 day maximum time period for the calling of a shareholder meeting to challenge a pre-approved rights plan.

We do not support lowering or dispensing with minimum ownership requirements to requisition such meetings. The current 5% ownership threshold provides some assurance that meetings will be called only where there is a reasonable prospect of obtaining the necessary support to remove the rights plan.

Summary

In summary, we support the approach of the CSA Proposal with the qualifications outlined above.

We thank you again for the opportunity to provide you with our comments. If you have any questions regarding the above, please feel free to contact our Executive Director, Stephen Erlichman, at 416.847.0524 or serlichman@ccgg.ca or our Director of Policy Development, Catherine McCall, at 416.868.3582 or cmccall@ccgg.ca.

Yours very truly,

Daniel E. Chornous, CFA
Chair of the Board
Canadian Coalition for Good Governance

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Alberta Teachers' Retirement Fund Board
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