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British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Nova Scotia Securities Commission
New Brunswick Securities Commission
Prince Edward Island Securities Office
Office of the Superintendent of Securities, Government of Newfoundland and Labrador
Department of Community Services, Government of Yukon
Office of the Superintendent of Securities, Government of the Northwest Territories
Legal Registries Division, Department of Justice, Government of Nunavut

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Dear Sir/Madam:

**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 Autorite des marches 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") and appreciate the extended window and opportunity to provide comments.

By way of background, Hermes is one of the largest asset managers in the City of London. As part of our Equity Ownership Service (Hermes EOS), we also respond to consultations on behalf of many clients from around Europe and the world, including PNO Media (Netherlands) VicSuper of Australia and the UK's Lothian Pension Fund (only those clients which have expressly given their support to this response are listed here). In all, EOS advises clients with regard to assets worth more than Canadian $140 billion.

***Overview***

We have considered the CSA Proposal and the AMF Proposal and support parts of each proposal, but also recognize the positive evolution of shareholder rights plans ("rights plans") in Canada. We believe that a quite workable shareholder rights plan has been negotiated and is in force at many large Canadian issuers today. We see the tactical rights plan, adopted without shareholder approval, as undesirable. We agree that rights plans should only address takeover bids, and that the provisions of rights plans should be more uniform across the spectrum of small and large listed issuers. Finally, we support the AMF Proposal recommendation to ensure any anti-takeover provision is terminated once a majority of shares are tendered to a bid. These positions are discussed more fully below.

Shareholder influence on rights plans in Canada

The Toronto Stock Exchange ("TSX") requirement that shareholders approve a rights plan has given investors the leverage needed to improve these plans and narrow their effectiveness to the accepted goals of giving the board more time to find an alternative bid or transaction, and to ensure fairness to all shareholders. This evolution would not have been possible without the leverage of the vote. We note that compared to the United States, SRPs in Canada evolved considerably more because institutional investors, with assistance from their advisors, have been able to negotiate better terms. However, evidence of this impact is more visible at large corporations where a significant proportion of its owners are institutional investors.

An important part of the evolution of rights plans in Canada was the inclusion of a permitted bid feature in the early 1990s. This recognized that the ultimate decision to accept a bid rests with shareholders, not directors or management, except so far as they too are shareholders.

Not all shareholder rights plans are created equal

Rights plans are complex documents and are difficult to understand. Summaries often do not fully explain the potential impact of a rights plan. For example, we have seen some rights plans where a change in a majority of the directors serving on the board is clearly a triggering event, even though such change may be effected by existing shareholders. In early iterations of rights plans with permitted bid provisions, there were often onerous daily reporting requirements for a bidder to follow. The initial permitted bid rights plans ("old generation rights plans") had provisions that created sort of a minefield and thus acted as a significant deterrent to a legitimate bidder.

Analysis of rights plans and their potential impact on takeovers and legitimate governance activities has, because of their complexity and resultant skills and resources required to analyse them, only been widely available to institutional investors. Retail investors do not typically have such resources, and

most do not even vote their proxies[1]. Consequently, issuers with a large institutional investor base tend to adopt the most refined ("new generation") rights plans.

There is evidence, according to Institutional Shareholder Services, that smaller Canadian issuers with ownership of largely retail investors that do not face the scrutiny of institutional investors and their advisors, generally adopt and routinely get approval for rights plans with a number of onerous provisions that could pose a significant barrier to a potential bidder or legitimate corporate governance activities.

Consequently, we believe that the current system has been balanced in the case of issuers largely owned by institutional investors, but not so for smaller issuers that are not subject to the same degree of oversight. We believe that many investors do not understand the potential power that old generation rights plans afford to a board of directors that seeks to entrench itself in power.

We therefore agree with the CSA's position that rights plans should address only takeover bids, not other governance activities that may be initiated by shareholders. Further, we agree that if a board waives a rights plan in respect of one bid, it must be waived for all bids. These attributes are currently features of new generation rights plans.

Because the shareholder vote has not created a level playing field in the evolution of rights plans, we suggest that the CSA consider requiring clear and simple rules for permitted bids, as found in new generation rights plans. That is, to remove the pitfalls, overly broad definitions and potential for director discretion that can create uncertainty and unnecessary hurdles for bidders and thus deter bids.

The CSA suggests that a rights plan should be approved annually by shareholders. New generation plans generally required shareholder confirmation every three years. We think three years is acceptable, but that annual approval is preferred. We believe there is less reason for securities regulators to become involved in removing a rights plan if its adoption has recently been approved by shareholders.

We prefer the evolved, new generation rights plan, incorporating some of the recommendations from the CSA and AMF comment papers, to the alternatives proposed by the regulators.

The tactical shareholder rights plan (or "tactical rights plan")

The TSX rules afford an issuer with the opportunity to adopt a rights plan and defer putting it to a shareholder vote for up to 6 months. This has given rise to the adoption, without any intent to seek subsequent shareholder approval, of tactical rights plans by issuers in the face of a takeover. We do not believe that this application of rights plans was anticipated by the TSX when it enacted as a listing requirement, that issuers secure shareholder approval of rights plans within 6 months of adoption.

We firmly believe that the requirement of the TSX for a vote to approve rights plans has, over many years, enabled the negotiation of rights plans with rights and restrictions that properly balance the interests of the bidder, on one side, and the corporation and its shareholders on the other. However, we believe that many issuers do not adopt and maintain shareholder approved rights plans because tactical rights plans are an option. We have concerns over this trend because tactical rights plans can

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[1] Broadridge 2012 Proxy Season, Key Statistics and Performance Rating, 42.5% of ballots representing 1000 shares or less were returned with voting instructions in 2012.

have provisions that make it a more potent takeover deterrent than a rights plan that would be presented to shareholders for approval.

We believe that tactical rights plans, if allowed to continue even for a reduced maximum period of 90 days as proposed by the CSA, will require that the CSA be involved in determining when they have to go, since provisions of the tactical rights plans can be very onerous, and they are adopted with only the approval of management and the board, whose interests, as noted in the CSA paper, may not be aligned with those of other shareholders.

The CSA proposal does not adequately address the provisions of rights plans and the AMF proposal does not do so at all. Given the potential deterrent effect of a tactical rights plan under the current regime and those proposed by the AMF and CSA, we do not accept that a rights plan should be effective at all, without prior shareholder approval.

We believe it is the continued use of tactical rights plans that will most likely give rise to the need for regulator intervention, because shareholders cannot influence the terms and restrictions of these rights plans and obtaining a vote on them is difficult and requires a special meeting.

Removing a shareholder rights plan by shareholder vote

We see this as potentially problematic, as management controls the proxy process and management's interests may not be aligned with those of shareholders. For example, management that seeks to block a takeover bid may employ several tactics that stack the deck against shareholders:

- Divert their own time and shareholders' own money (from treasury) to solicit proxies against vote to remove a rights plan;
- Pay a performance fee to a third party to solicit votes against removal of a rights plan;
- Waive the deadline for submitting proxies and extend their solicitation efforts right to the day of the meeting.

We also note that the potential that exists in the proxy voting system for inappropriate vote borrowing strategies that could be employed to defeat a resolution to remove a rights plan and block a bid.

Consequently, we support the AMF's proposal to amend the securities laws (NP 62-202) to require that any anti-takeover provision fall aside if a majority of shares are tendered to a bid. Given the problems of shareholder meetings as noted above, we believe that approval of a bid by way of majority tender is a superior method to determine when a bid should go forward. This too is a provision found in new generation rights plans.

Management and directors right to vote

As noted above, we believe that obtaining shareholder approval prior to the implementation of an anti-takeover provision ensures there is opportunity for negotiation. In the event that a vote to remove a rights plan is required or desirable, we believe that management and directors should be allowed to vote on the removal of a pill that was recently approved or re-approved by shareholders. However, we do not believe that their votes should be counted in a contest to remove a tactical rights plan that has not been approved by shareholders.

We suggest that the above restriction on management votes would also act as an incentive for smaller issuers to adopt new generation type plans. From our Canadian experience, we have seen that management of smaller issuers, which more often adopt pills with unduly restrictive terms, often hold a more significant percentage of equity than management of large issuers (which usually adopt new generation plans). Consequently, we believe that management and directors would want to retain their right vote on removal of a rights plan, and thus provide an incentive to adopt a new generation plan, which is more likely to be approved.

***Summary***

In summary, we support parts of both proposals, but we encourage the securities administrators to require any Canadian-domiciled company to obtain advance shareholder approval for the adoption of any plan or action that is intended to make a takeover bid more difficult. We encourage the advancement of the new generation rights plan as the right standard for Canada.

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 me at 416.417.0173 or w.mackenzie@hermes.co.uk.

Yours very truly,

Bill Mackenzie
Senior Advisor - Canada
Hermes Equity Ownership Services