Avoiding Surprise Activism at Your Annual Shareholders Meeting: Adopting Advance Notice By-Laws

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Highlights
- Advance Notice By-Laws limit the ability of shareholders to surprise the issuer by nominating alternative directors at the annual general meeting without prior notice to the issuer;
- Advance Notice By-Laws increasingly seen as the best tool to defend against activist shareholders planning a surprise nomination of alternative directors at an annual shareholders meeting;
- Growing support for and use of Advance Notice By-Laws by Canadian issuers;
- ISS and Glass Lewis support Advance Notice By-Laws under certain conditions;
- Advance Notice By-Laws have already been tested in a Canadian court and were validated and enforced;
- Advance Notice By-Laws are more common in the United States.

Why Should You Adopt an Advance Notice By-Law?
With the rise of shareholder activism in Canada, executives of public companies might have become nervous when it comes to the proxy season. A study recently conducted by Fasken Martineau, 2013 Canadian Proxy Contest Study, confirms that proxy contests are on the rise and that no one is immune to them. According to the study, a total of 101 contests were completed during the 2008-2012 period, representing an increase of 84% over the preceding five-year period. As noted in the study, the last five years have seen a 98% increase in the number of contests focused on change in the boardroom and in 54% of these board-related contests, dissident shareholders were successful. This trend is likely to continue and grow, especially as a number of institutional shareholders embark on shareholder activism and other activist titans like Bill Ackman of Pershing Square and Carl Icahn now actively eye Canadian companies.

Activist or disappointed shareholders have typically tried to influence an issuer by attempting to replace the current directors with their own candidates by issuing a shareholder proposal which needs to be added to the issuer’s management proxy circular or by starting a proxy fight by sending to shareholders a dissident proxy circular. A disappointed shareholder may also wait until the annual shareholders meeting of the issuer to nominate alternative candidates from the floor and try to rally support from other shareholders. In this case, the issuer’s management may be completely taken by surprise and depending on the composition of the issuer’s shareholding, management may lose the vote and find itself with unexpected new board members.
Advance Notice By-Laws: A Simple but Efficient Tool

Advance Notice By-Laws are useful to prevent the latter situation. Such by-laws set a deadline by which shareholders must submit a notice of director nomination to the issuer’s management prior to the annual meeting. The by-laws also set forth the information that a shareholder must include in the notice for it to be valid. It is intended to allow the issuer and its shareholders to receive adequate prior notice of director nominations, as well as sufficient information on all the nominees and, consequently, it is also intended to allow the shareholders to better evaluate the proposed nominees’ qualifications and suitability as directors. Typical Advance Notice By-Laws will provide details on the nomination procedures to be followed by a “nominating shareholder”. The nominating shareholder will need to send a timely notice to the issuer and in accordance with the current practice and what has been deemed reasonable by the main actors in corporate governance, such notice should be sent to the issuer not less than 30 nor more than 65 days prior to the date of the annual shareholders meeting. In the case of a special meeting of shareholders during which directors will be elected, the notice should be sent no later than 15 days following the day on which the first public announcement of the date of the special meeting of shareholders is made. Of course, it is important to always remember that the nominating procedure is also subject to the corporations act governing the issuer and to its articles.

Strong Support from Corporate Governance Actors

Institutional Shareholder Services Inc. (ISS), an influential corporate governance and proxy advisor, has changed its voting recommendation this year with regard to advance notice requirements. ISS will now make its voting recommendation on a case-by-case basis on proposals to adopt an advance notice board policy or to adopt or amend by-laws containing or adding an advance notice requirement. It will give support to those proposals that provide a reasonable framework for shareholders to nominate directors by allowing shareholders to submit director nominations as close to the meeting date as reasonably possible and within the broadest window possible, recognizing the need to allow sufficient notice for issuer, regulatory, and shareholder review. ISS finds that to be reasonable, the issuer’s deadline for notice of shareholders’ director nominations must not be more than 65 days and not less than 30 days prior to the meeting date. ISS’s stated rationale for supporting reasonable Advance Notice By-Laws is:

“All shareholders should be provided with sufficient disclosure and time to make appropriate decisions on the election of their board representatives. Advance Notice Requirement Policies typically provide a transparent, structured, and fair director nomination process, whereby all shareholders, irrespective of whether they are voting by proxy or attending the meeting, are made aware of potential proxy contests in advance of the meeting. Shareholders are also provided with important information pertaining to proposed dissident director nominees within a specified time frame, allowing shareholders to fully participate in the director election process in an informed and effective manner.”

Like ISS, Glass Lewis & Co., another major corporate governance player, supports the adoption of reasonable Advance Notice By-Laws:

“While we recognize the increased burden that could be placed on small shareholders that wish to nominate directors to a company’s board under an advance notice policy, we believe that these costs are minimal compared with the potential negative impact resulting from an overhaul of a company’s incumbent board. Accordingly, Glass Lewis will generally support these policies...”
that require a nominating shareholder to provide notice not less than 30 or and not more than 65 days prior to the date of the annual meeting.”

The Mundoro Case
The Supreme Court of British Columbia has also shown support for Advance Notice By-Laws in a recent decision, Northern Minerals Investment Corp. v. Mundoro Capital Inc., 2012 BCSC 1090. In this case, Mundoro’s board of directors had adopted an Advance Notice Policy requiring shareholders to nominate a director by a fixed deadline and in compliance with the terms of the Advance Notice Policy, which was not an Advance Notice By-Law approved by shareholders however. NMI, an 8% shareholder, argued that there was no legal basis for adopting such a policy and petitioned the British Columbia Supreme Court for a declaration that Mundoro’s Advance Notice Policy was unenforceable.

The Court noted that the petitioner did not produce any evidence that the directors of the issuer were acting other than in the best interests of the shareholders of the company. It noted that it was the intended actions of the petitioner that would not have been in the best interests of the shareholders as “the late announcement by the petitioner of its intentions would not permit sufficient time to insure that all shareholders were advised and given the opportunity to attend or submit their proxies”.

NMI submitted that the result of the Advance Notice Policy was that the board of the issuer could entrench itself and that the directors were improperly seeking to protect and benefit themselves. The Court rejected this argument. NMI also submitted that the Advance Notice Policy affected shareholder democracy because it deprived shareholders of their right to elect directors in accordance with the British Columbia Business Corporations Act. The Court responded to this submission by saying that neither the act nor the articles of the company expressly precluded directors from creating such a policy and the Court insisted on the fact that nothing demonstrated that such policy was infringing on shareholder rights. The Court said that rather than infringing the rights of shareholders, the policy ensured an orderly nomination process and that the shareholders are informed in advance of a meeting what is in issue. The Court further commented that the policy prevented a group of shareholders from taking advantage of a poorly attended shareholders meeting to impose their slate of directors on what could be a majority of shareholders unaware of such a possibility arising.

Finally, the Court declined to declare the Advance Notice Policy unenforceable and concluded as follows:

“The actions of the board in this instance in creating an advance notice policy have not been shown to having been done to “influence or preclude” a proxy contest but rather to insure that all shareholders are made aware that a proxy contest exists. No evidence has been put forward that the directors are not behaving reasonably.”

Adopting an Advance Notice By-Law
Advance Notice By-Laws are common in the United States and have been adopted by many large issuers. In Canada, although such by-laws seem to have been adopted more rapidly by smaller companies, we are currently noticing a rise in the adoption of such policies by Canadian issuers. Adopting Advance Notice By-Laws is simple and constitutes, at present, the most efficient way to prevent surprises at shareholders meetings.