OSLER

New guidance on soliciting dealer arrangements

MAY 31, 2019 6 MIN READ

Related Expertise

- Capital Markets
- Corporate Governance
- Mergers and Acquisitions

Authors: James R. Brown, Jeremy Fraiberg

The use of soliciting dealer arrangements in Canada – where issuers pay fees to investment dealers to get securityholders to vote in favour or support certain actions – has been subject to scrutiny for a number of years. The 2013 proxy contest involving JANA Partners and Agrium and the 2017 proxy contest involving PointNorth Capital and Liquor Stores N.S. raised a number of questions around the use of such arrangements in contested director elections due to the one-sided fees paid to soliciting dealer groups for votes cast in favour of the management slate. Some critics alleged that these arrangements amounted to "vote buying" and create investment dealer conflicts of interest. Soliciting dealer arrangements are also used in a number of other contexts, such as supported and uncontested take-over bids, where the conflicts of interest are not as acute.

In 2018, the Canadian Securities Administrators (CSA) issued a Staff Notice seeking information and feedback on the use of, and regulatory approach to, soliciting dealer arrangements. In response, the Investment Industry Regulatory Organization of Canada (IIROC) — the investment dealer self-regulatory organization — recently published a Guidance Note to address management of conflicts of interest concerning such arrangements. The Guidance Note provides some welcome clarity on IIROC's views on the use of soliciting dealer arrangements in the context of takeover bids, plans of arrangement, proxy contests and other transactions involving various types of solicitation fees.

While not having the force of a rule change or a change in law, given the CSA's endorsement of the Guidance Note and the lengthy consultation with the dealer and issuer community, we expect the Guidance Note will have an impact on the way that soliciting dealer arrangements are structured going forward. One-sided fee arrangements in contested director elections will almost certainly be precluded, though a number of questions still remain about how practice will evolve. In particular:

- Will dealers conclude that one-sided (i.e., success) fee arrangements can still be managed from a conflicts perspective in director elections or in other contested situations?
- Will the Guidance Note have an impact on neutral fee arrangements designed to "get out the vote," or will all soliciting dealer arrangements be affected?
- Are soliciting dealer arrangements a legitimate use of corporate funds, and are boards of directors acting in compliance with their fiduciary duties when entering a one-sided fee arrangement?
- Can dealers discharge their obligations and manage conflicts of interest when being paid a transaction success fee while being paid a success-based fee in a soliciting dealer arrangement?

Soliciting dealer arrangements

As noted by the CSA and IIROC, "soliciting dealer arrangements" generally refer to agreements entered into between issuers and one or more registered investment dealers under which the issuer agrees to pay to the dealers a fee for each security successfully solicited from securityholders to: (i) vote in connection with a matter requiring securityholder approval, (ii) tender securities in connection with a takeover bid, or (iii) participate in a rights offering or exercise rights to redeem or convert securities, or otherwise in connection with corporate transactions to attain the requisite quorum for amendments to documents affecting the rights of security holders. These arrangements provide an opportunity for issuers to connect with their security holders and generally make them aware of corporate transactions and to seek security holder engagement. In consideration of these efforts, soliciting dealers are paid a fee by the issuer – in some cases a fee that is contingent on a favourable vote by the relevant security holder.

Conflicts of interest and IIROC guidance

The Guidance Note confirms that the proper management of conflicts of interest is a priority for IIROC (and, consequently, the CSA). Conflicts of interest are generally regulated under IIROC Dealer Member Rule 42 and its related guidance. Under that rule and the related guidance, dealers must address conflicts of interest that, or that could, arise with different business models.

In respect of soliciting dealer arrangements, the Guidance Note provides a combination of guidance on suggested policies and procedures and provides clear view as to those conflicts that should be avoided.

Conflicts to be avoided

The Guidance Note states that soliciting dealer arrangements that relate to contested director elections involving fees that are paid only for votes in favour of one side and/or only if a particular side is successful raise significant conflicts of interest for a Dealer which, in the opinion of IIROC, are unmanageable and therefore should be avoided. IIROC notes that in these cases, because of the competing qualitative assessments that are required in a contested director election, it is unlikely that the Dealer would be able to provide objective advice in light of the fee arrangement and the nature of the information made available in a contested director situation.

As a result, we expect that the dealer community will move away from the above-noted fee arrangements in contested director elections in Canada.

Other conflicts of interest

Outside of soliciting dealer arrangements in contested director elections with one-sided fee arrangements, soliciting dealer arrangements should be considered by dealers in light of the specific transaction and whether the arrangements give rise to material conflicts of interest. The Guidance Note that one-sided or contingent arrangements can also give rise to conflicts in other contested transactions (such as a contested plan of arrangement), and therefore dealers must have policies and procedures in place to manage such conflicts.

IIROC notes that soliciting dealer arrangements that are neither one-sided nor contingent on a particular result may not always raise conflicts or regulatory concerns, and therefore

dealers should assess and address each such arrangement in accordance with its conflicts of interest management practices.

The Guidance Note remarks that while disclosure of a conflict is important in addressing potential conflicts of interest, it is generally an inadequate mechanism to address a conflict of interest arising from a soliciting dealer arrangement as it may have a limited (or contradictory) impact on the client's decision-making regarding the conflict. As such, IIROC recommends that in cases of a conflict, in addition to disclosing the conflict, a dealer should identify how they have addressed the conflict of interest in the client's best interest.

However, in making disclosure to a client regarding a conflict concerning a soliciting dealer arrangement, IIROC expects the dealer to make disclosure:

- in writing in a timely manner;
- providing sufficient information regarding the arrangement and conflict to permit the client to make an informed decision;
- that is understandable to the client; and
- that is prominent, complete, in one place and in plain language.

Conclusion

In light of the new Guidance Note, dealers will need to revisit their policies and procedures relating to conflicts of interest and consider the application of these policies and procedures to potential soliciting dealer engagements. Issuers should be aware of the Guidance Note and the potential impact the guidance could have on structuring of soliciting dealer arrangements. It remains to be seen how the dealer community will respond to the Guidance Note outside of contested director election circumstances and whether practice will shift to soliciting dealer arrangements based on participation rather than success, or whether soliciting dealer arrangements will become less relevant to Canadian practice.