DAVIES

GOVERNANCE INSIGHTS 2024

A Preview of 2024: 10 Trends That GCs and Boards Need to Know

In this article, we explore 10 important trends that should be of interest to general counsel and boards in their strategic and compliance planning.

1 | Boards Should Expect Continued Attention from Activists

As we discussed in our article on shareholder activism, 2023 was a banner year for activism in Canada. No fewer than 47 companies were targeted by activists (excluding shareholder proposals), well in excess of even pre-pandemic levels of activity. We see little reason to expect this activity to abate in 2024. While scrambled macroeconomic indicators may have tempered the market for public M&A activity, continued uncertainty is unlikely to dissuade activists from taking on underperforming companies. As evidenced by the trend of activist "swarms," most recently witnessed with Gildan Activewear as 2023 drew to a close, even shareholders who would not typically be viewed as having an activist posture are becoming more vocal.

In addition, the shareholder-friendly decision of the Ontario Superior Court in *Sandpiper*, which rejected a target board's decision to substantially postpone a requisitioned shareholder meeting, may provide some hope to activists that the courts will provide a more sympathetic ear should they need to seek judicial recourse while pursuing a proxy campaign. Accordingly, public company boards should remain attuned to feedback from their shareholders and proactively address criticism, given that negative feedback can be a harbinger of an upcoming activist campaign. In addition, public company boards considering actions that may affect shareholder voting rights should be particularly conscientious about managing the board's process and director conflicts.

For a more detailed discussion of the *Sandpiper* decision, including the conflict issues that arose, see our bulletin *Time (and Process) of the Essence: Ontario Court Accelerates Timing of Requisitioned Meeting*.

2 | "Vote-No" Campaigns May Gain Prominence as an Activist Tool

With the adoption of the August 2022 amendments to the *Canada Business Corporations Act* (CBCA) to introduce true majority voting for directors, a "vote-no" campaign can now yield concrete results whereby a director candidate receiving a majority of "no" votes will fail in his or her election. While we are aware of only one vote-no campaign against a CBCA company in 2023, future campaigns may be on the horizon. For example, recommendations from proxy advisory firms to vote against certain directors owing to alleged governance shortcomings could have greater impact, especially if used by key shareholders to catalyze a larger vote-no campaign. Pursuing a vote-no campaign can be relatively cost-effective and result in a course change at a target even if the campaign does not succeed in dislodging an incumbent director. In that regard, directors whose votes fall dangerously close to negative territory may feel pressure to address shareholder criticisms. As shareholders of CBCA companies now have greater influence at the ballot box, attention has turned to how incumbent directors may best protect themselves. In our view, a target's best defence is to ensure a robust and ongoing campaign of shareholder engagement and appropriate responsiveness to shareholder feedback.

3 | Mandatory Climate Disclosure: Here to Stay (Eventually)

As reported in the 2022 edition of Davies' *Governance Insights*, in October 2021, the Canadian Securities Administrators (CSA) released for public comment proposed National Instrument 51-107—*Disclosure of Climate-related Matters* (CSA Proposal), which was aimed at improving the consistency and comparability of climate disclosure and aligning Canadian disclosure standards with the expectations of international investors and, more generally, assisting investors in making informed investment decisions. Currently, Canadian securities law requires issuers to disclose any material information, including material climate-related information. The CSA Proposal imposes a more stringent disclosure requirement, calling for the disclosure of specified climate-related information even if, in some cases, this information is not considered material.

Despite the targeted effective date of December 31, 2022, the implementation of the CSA Proposal has been put on hold while the CSA studies the proposal of the U.S. Securities and Exchange Commission (SEC) for *The Enhancement and Standardization of Climate Related Disclosures for Investors* (SEC Proposal) published in March 2022, as well as the International Sustainability Standards Board's IFRS S1 (General Requirements for Disclosure of Sustainability-related Financial Information) and IFRS S2 (Climate-related Disclosures) (ISSB Standards) issued in June 2023.

Although neither the CSA Proposal nor the SEC Proposal has yet been adopted, we expect that the ISSB Standards and recent developments in the proxy sphere will inform Canadian issuers' climate-related disclosure for 2024 and going forward. For example, *The Globe and Mail*'s "Board Games" introduced three new criteria in 2023 aimed at evaluating board oversight for the environment, and the climate expertise and climate training of directors. Similarly, in its 2024 benchmark policy guidelines for Canada, Glass Lewis & Co. (Glass Lewis) expanded its climate-related disclosure policy adopted just last year to apply to TSX 60 companies operating in industries that the Sustainability Accounting Standards Board has determined have material exposure to climate risk. While Canadian public companies await the enactment of formal climate-related disclosure rules, investor expectations are likely to drive enhanced climate-related disclosure during this interim period.

4 | Cybersecurity: A Renewed Governance Frontier

The CSA last issued cybersecurity governance and disclosure guidance in 2016 as part of an initiative to increase cybersecurity awareness and resilience among market participants. As we anticipated that year in Davies' *Governance Insights*, we believed that managing cybersecurity risks and their potentially significant exposures would continue to be a top priority for many boards.

Since then, virtually all Canadian public company boards have adopted formal cybersecurity risk management practices and policies as a key part of their overall risk oversight frameworks. Although Canadian securities regulators have not yet issued updated cybersecurity guidance, we expect cybersecurity to remain at the fore of boards' risk management priorities in 2024. This view is informed partly by new cybersecurity risk management, strategy, governance and incident disclosure rules adopted by the SEC in 2023, and partly by shareholder expectations. In its 2024 benchmark policy guidelines for Canada, Glass Lewis expanded its cybersecurity voting guidelines adopted just last year to caution that, in instances in which a company has been materially impacted by a cyberattack, Glass Lewis may recommend against appropriate directors should it find the board's oversight, response or disclosure concerning cybersecurity-related issues to be insufficient or not sufficiently transparent. In light of a number of high-profile cyberattacks that affected Canadian public companies in 2023, it would be prudent for issuers to review and update their existing cybersecurity practices and policies against best practices.

5 | Transaction Structuring and Mandatory CRA Disclosure Rules

In June 2023, Canada implemented new mandatory disclosure rules relating to reportable and notifiable transactions and reporting of uncertain tax positions. These rules are very broad, potentially requiring disclosure in respect of many "ordinary course" commercial transactions. In particular, the reportable transaction rules provide for reporting in respect of any transaction that includes one or more steps, one of the main purposes of which was to achieve a tax benefit involving any of the following three purported hallmarks of aggressive tax planning: (i) a promoter or adviser being entitled to certain contingent fees based on the tax results; (ii) a promoter or adviser obtaining "confidential protection" with respect to the tax structuring; and (iii) the taxpayer or certain other persons obtaining "contractual protection" with respect to the tax consequences of the transaction. The notifiable transaction rules require reporting of certain listed categories of transactions, and transactions that are the same or substantially similar to these transactions. So far, the Canadian Revenue Agency (CRA) has identified five categories of notifiable transactions, but more may be added in the future. The CRA has provided some guidance to date on these rules that suggest it intends to apply these rules to a more limited set of circumstances than the rules may otherwise suggest. We expect the CRA to provide further guidance on these rules, which will hopefully further narrow the scope.

In addition to these changes, Canada has proposed revisions to the general anti-avoidance rule to expand its scope, and provide for the imposition of penalties where the general anti-avoidance rule is found to apply, unless reporting is made under the mandatory reporting rules or similar reporting is made voluntarily by the taxpayer.

6 | *Competition Act* Amendments Change the Game

The competition landscape is shifting and trending toward an expansion of the Competition Bureau's powers and potentially increased liability for companies. Both enacted and proposed changes to the *Competition Act* made a big splash in 2023 that will continue to ripple into 2024. Practitioners will be grappling with the first set of changes that came into effect on December 15, 2023, and preparing themselves for additional changes set to take effect on December 15, 2024, as well as others currently under consideration by Parliament. For a detailed summary of the recent and proposed changes to the Competition Act, see our bulletin *A New Era for Canadian Competition Law: Landmark Proposed Changes to the Competition Act Announced*.

Our bulletin highlights a few of the recent amendments which: (i) expanded the scope of private litigation under the *Competition Act*; (ii) increased the focus on anticompetitive collaborations, including the Competition Bureau's power to prohibit anticompetitive vertical agreements; (iii) expanded the abuse of dominance provisions to include "excessive and unfair selling prices"; (iv) changed the merger review process, including repeal of the efficiencies defence; (v) added a new civil provision prohibiting certain "greenwashing" claims; and (vi) reduced the scope for cost awards against the Commissioner.

We expect some growing pains in 2024 as the Competition Bureau seeks out test cases for its new powers, and as companies navigate the new rules. In addition, companies will need to evaluate their existing practices and consider how these new and proposed amendments may impact their current practices and how they think about, assess and manage competition risk.

7 | Artificial Intelligence Continues to Advance

The year 2023 was marked by an explosion of interest in AI as a result of the success of “large language models” (such as ChatGPT) that proved to be captivating, inspiring and—in some cases—frightening. The fact is, AI is not new, ChatGPT is not “artificial general intelligence” (AGI), and it is unlikely that anyone will conclude—at least in the foreseeable future—that it would be wise to cede corporate decision-making to an AI technology. So how should boards and management approach AI in 2024?

While experts disagree on how much runway we have until AGI fundamentally alters the way we work, think and interact, boards and management can take a number of actions in the interim, including: (i) understanding the use cases of current AI technology for the business; (ii) understanding the risks inherent in the use of AI technology; and (iii) developing an AI governance policy to help address current risks and to provide a framework to address what is yet to come.

For a primer on artificial intelligence and some concrete examples of steps boards and management can take today to address the risks and opportunities of AI, see our article, *Get Smart on Artificial Intelligence and Corporate Governance: Key Considerations for Boards of Directors*.

8 | Board Committees: Preserving Privilege and Confidentiality

In Canada, most corporate statutes provide directors with unfettered access to corporate records, including privileged documents. Even side communications between any member of the board and counsel, management or third parties are accessible and discoverable by all directors. While this rule makes sense in the normal course, there are many situations in which this access would be inappropriate (e.g., when a board committee is overseeing material conflict of interest transactions or conducting an investigation). In these situations, the ability of a board committee to keep certain information confidential from other directors, or retain privilege over such information, can be of critical importance and fundamental to its mandate.

While Canadian jurisprudence has provided limited exceptions to the otherwise unfettered right of access (e.g., limiting information available to a director who is being sued by the corporation), we note that under Delaware law, privilege can be

established by a committee against other board members: (i) by *ex ante* agreement; (ii) openly and with the knowledge of the excluded director by appointing a special committee that engages its own counsel; or (iii) once sufficient adversity exists between the director and the corporation to the extent that the director can no longer have a reasonable expectation that he or she is a client of the board's counsel.

To date, we are not aware that this issue has been tested in Canadian courts; however, we anticipate that in light of recent jurisprudence and other potential regulatory developments, board special committees may be established with greater frequency as a conflict-management tool. That trend, coupled with ever-increasing scrutiny on board decision-making processes, suggests that board committees should focus at an early stage on how best to manage matters of privilege and confidentiality.

9 | Virtual-Only Shareholder Meetings: A Relic of the Pandemic?

Prior to the 2020 COVID-era proxy season it was relatively uncommon for Canadian public companies to permit virtual attendance at shareholder meetings, and almost no issuers held virtual-only meetings. During COVID, it became increasingly common for Canadian public companies to hold meetings in a virtual-only or hybrid format, and it appears some issuers are hesitant to move back to a traditional in-person meeting with its attendant costs and, in some cases, exposure to shareholder scrutiny and public criticism. Indeed, the practice of holding virtual-only shareholder meetings is receiving push-back from proxy advisors and shareholder rights advocates — a trend we expect will continue into the coming 2024 proxy season.

In its 2024 report, Glass Lewis noted that a growing number of companies have elected to hold virtual-only shareholder meetings and expressed concern given that virtual-only meetings have the potential to curb the ability of a company's shareholders to ask questions and meaningfully participate in the meeting. Glass Lewis recommends voting against the chair of the governance committee if a board is planning to hold a virtual-only shareholder meeting where specified procedural and disclosure criteria are not satisfied.

In 2024, we expect that proxy advisors and shareholder advocates will be keeping a close eye on the use of virtual-only meetings and the manner in which shareholders are permitted to participate. While issuers may view virtual meetings as way to save costs, to avoid unwarranted scrutiny issuers should seek to provide a meeting platform to shareholders that ensures, to the extent practicable, that they have the same rights and opportunities to participate as they would at an in-person meeting.

10 | Evolving Views on Director Independence

In 2023, two court decisions (*Sandpiper* and *In re Columbia Pipeline*) hinted at a potential expansion in scope of potential director conflicts. In 2024 and beyond, these decisions may inspire other courts and regulators to review potential conflicts more closely, and shareholders and other parties in contested transactions to pursue real or perceived conflicts as an additional avenue of attack.

In *Sandpiper*, a shareholder requisitioned a meeting and targeted certain directors in its withhold campaign; an Ontario court held that the targeted directors were conflicted in their deliberations regarding the response to the requisitioned shareholder meeting. In the decision in *In re Columbia Pipeline*, a Delaware court found a director, who was also CEO and Chair of the Board, had breached his fiduciary duty based on “situational” factors unique to his personal circumstances. In particular, the director was leading negotiations for a change-of-control transaction with a third party, while intent on completing a transaction that would allow him to retire within the year and retain the change-of-control benefits that would accrue under his existing equity compensation plan, setting up a clear situational conflict in which his personal considerations collided with the interests of the corporation in the merger negotiations.

These decisions remind us that director independence is a fact-driven analysis that needs to be thoughtfully undertaken in each case of potential conflict (regardless of how tenuous the conflict may seem) in order to determine whether the board member or officer can exercise (and be perceived to exercise) independent judgment in the circumstances. We anticipate a potential enhanced focus on what circumstances may be viewed as clouding a director’s judgment, including lengthy tenures and other “practical” and situational conflicts.

Key Contacts

Toronto

Patricia L. Olasker

416.863.5551
polasker@dwpv.com

Aaron J. Atkinson

416.367.6907
aatkinson@dwpv.com

Brett Seifred

416.863.5531
bseifred@dwpv.com

Montréal

Franziska Ruf

514.841.6480
fruf@dwpv.com

New York

Jeffrey Nadler

212.588.5505
jnadler@dwpv.com

Contributors

Researching and writing this report is a project undertaken by Davies Ward Phillips & Vineberg LLP and not on behalf of any client or other person. The information contained in this report should not be relied upon as legal advice.

Aaron Atkinson
Andrew Mihalik
Marc Pontone
Brett Seifred

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DAVIES

TORONTO

155 Wellington Street West
Toronto ON Canada
M5V 3J7

416.863.0900

MONTRÉAL

1501 McGill College Avenue
Montréal QC Canada
H3A 3N9

514.841.6400

NEW YORK

900 Third Avenue
New York NY U.S.A. 10022

212.588.5500

DAVIES WARD PHILLIPS & VINEBERG LLP