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canadian pacific railway (a): border skirmish or nuclear winter?[[1]](#endnote-1)

Karin Koopmans wrote this case under the supervision of Murray Bryant solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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On January 4, 2012, John E. Cleghorn, the chair of the board of directors for one of Canada’s oldest railway companies, Canadian Pacific Railway (CP), received a rather blunt e-mail from Bill Ackman, the chief executive officer (CEO) of CP’s largest shareholder, Pershing Square Capital Management (Pershing). In the e-mail, in which Ackman stated that “war is also not inevitable,” Ackman demanded that Cleghorn provide Pershing with two seats on the board of directors and approve the hiring of a new CEO of Ackman’s choosing. Cleghorn’s uncertainty about how to respond to Ackman’s request was documented in the email he had sent to Ackman that day: “Thank you for your email and for your phone message. Let me reiterate that we would like to reach an agreement which advances the best interests of the company. As you will appreciate, I will be discussing your email with my board.”[[2]](#endnote-2) Whatever decision Cleghorn made, it had to be in the best interests of shareholders.”

HISTORY OF CANADIAN PACIFIC RAILWAY

The Early Days

CP was one of Canada’s most recognized companies, with a history that dated back to the late 1800s. As part of Canada’s Confederation in 1867, the provinces that joined were promised a transcontinental railway to physically link them with the other provinces from east to west. The railroad’s early construction was fraught with controversy and politics until a group of Scottish-Canadian businessmen formed a viable syndicate and incorporated the Canadian Pacific Railway Company (CPRC) in 1881. Despite some continued building struggles, the last spike of the railroad was driven into the ground in Craigellachie, British Columbia, in 1885, and the first transcontinental train departed on June 28, 1886.[[3]](#endnote-3)

Throughout the early 1900s, CPRC expanded its business into land sales, telegraph lines, locomotive construction, and steamships, and served as the primary transportation network during World War II. The company also focused on expanding its rail network through acquisitions, particularly in the United States through the Soo Line in the Midwest and the Delaware and Hudson Railway in the Northeast. By 1986, CPRC was Canada’s second-largest company, with CA$15 billion[[4]](#endnote-4) in revenue.[[5]](#endnote-5)

The Modern Railroad

In 2001, the five subsidiaries created through various acquisitions by CPRC were spun into separate companies, leaving CP as an independent public company. The following decade witnessed continued expansion through track re-building, renewing locomotive fleets, modernizing information technology systems, and focusing on railroad safety; however, CP also faced significant challenges during this time. The company was often the focus of takeover rumours, including a widely reported rejection of a takeover inquiry from a private equity group led by Brookfield Asset Management in 2007.[[6]](#endnote-6) The company also suffered during the economic recession; in 2009, CP reported operating income of $830 million, reflecting a 20 per cent drop from 2008 levels. This decline was primarily due to lower traffic volumes, decreasing fuel prices, and a drop in both the freight rates and the average length of haul of coal exports.[[7]](#endnote-7) In 2011, severe weather and flooding caused significant train disruptions, resulting in an over 13 per cent decline in year-over-year operating income.[[8]](#endnote-8) CP was committed to executing its multi-year plan, which aimed to drive volume growth, expand network capacity, and control costs.[[9]](#endnote-9) See Exhibit 1 for a summary of CP’s key financials for 2007–2011.

By 2012, the company had grown to over 16,000 employees, operating in six provinces and 13 U.S. states across 14,700 miles of railway track.[[10]](#endnote-10) The railway transported a wide range of goods, including industrial and automotive products, food and agricultural products, forest products, and energy/wind energy products. Customer shipments were handled either through traditional transloading or through the use of intermodal containers, depending on customer needs and preferences.[[11]](#endnote-11) The transportation of unit trains (i.e., a shipment of multiple cars containing a single product) was considered more efficient and less complex than mixed-load trains, which had to make multiple stops and switch cars in and out of the train. As a result, mixed-load trains required more complex scheduling and labour utilization. Bulk products transported primarily by unit trains represented approximately 44 per cent of CP’s total revenues in 2012,[[12]](#endnote-12) with the remainder requiring mixed-train planning and execution.

the north american railroad INDUSTRY

Prior to the invention of the automobile, rail networks represented the sole means of long-distance travel. As such, railway operations in North America received significant political attention and continued to be viewed as an essential form of infrastructure.

The United States

The railroad industry in the United States had faced significant regulation since its origins in the early 1800s. The Interstate Commerce Commission was formed in 1880 to limit the exercise of monopoly power by local rail companies and stabilize the industry through the regulation of freight rates, formations and consolidations, and service levels. Unfortunately, the growth in regulation and resulting pace of approval stifled the industry, leading to financial crises and numerous firm bankruptcies from 1960–1980.[[13]](#endnote-13) In 1980, the industry was revolutionized by the Staggers Rail Act, which eliminated regulatory control of freight rates in the United States.[[14]](#endnote-14) Canadian firms were forced to respond to the resulting competitive pricing pressure, given their significant rail network within the United States.

Canada

Unlike in the United States, which from 1980 onwards was struggling with industry consolidation, in Canada, with extensive mergers and acquisitions starting after the repeal of the Staggers Rail Act in early 1980 and gathering momentum in the late 1990s, two key players dominated the railroad industry: CP and Canadian National Railway (CN). While rationalization of the rail network in Canada was limited by various regulatory restrictions, the effects of regulation were not as severe as the effects of regulations in the United States. The Canadian Transport Commission, which was responsible for adjudication and safety regulation, was disbanded in 1988 and its functions divided among various new bodies, significantly “deregulating” the industry and allowing competitive forces to prevail.[[15]](#endnote-15)

The Canadian and U.S. rail industries began to merge into a broad North American industry with acquisitions in the 2000s, given the significant cross-border assets and alliances between firms. The industry was heavily concentrated, with the seven largest Class I freight railroads accounting for 69 per cent of freight rail mileage, 90 per cent of employees, and 94 per cent of revenues.[[16]](#endnote-16) This concentration prompted governments on both sides of the border to maintain the regulation of anti-competitive railroad conduct. Noteworthy was that CN had made significant acquisitions in the United States and had evolved as a north/south railroad network, largely through a major acquisition of the Illinois Central Railroad, providing access to Chicago and points south and west; in contrast, in 2011, CP had largely focused on a Canadian railroad network—an east/west network.

Canadian National Railway Company

CN was formed in 1919 by the Canadian government to assume responsibility for a number of small railroads on the brink of collapse.[[17]](#endnote-17) As a Crown corporation,[[18]](#endnote-18) CN received government subsidies to support its operations—an action that was the topic of significant political debate. CN posted deficits from its inception up to the late 1970s, which the government absorbed as part of its budget. The company began to rise to profitability after 1978 by divesting non-core freight rail assets, including hotels, airlines, and telecommunication companies. Following deregulation, CN abandoned unprofitable rail lines it had been forced to absorb through prior government policies.

In 1995, the government initiated the largest privatization in Canadian history at the time by selling all of its CN shares under the CN Commercialization Act. The Act specified that the company’s headquarters must remain in Montreal, Quebec, and that no individual or corporation could own more than 15 per cent of CN’s shares.[[19]](#endnote-19)

In 1998, CN purchased the Illinois Central Railroad, shifting its focus from solely an east–west Canadian link to a north–south North American railway. The company also embraced “precision railroading,” which focused on stringent train scheduling to reduce terminal dwell time and improve asset utilization. For CN, this strategy produced industry-leading operating ratios and on-time performance.[[20]](#endnote-20)

By 2012, network rationalization, focused expansion, and operational improvements had transformed CN into a $9 billion company with over 23,000 employees, making it the largest railroad in Canada.[[21]](#endnote-21) Its focus on precision railroading contributed to a significant decline in the company’s operating ratio,[[22]](#endnote-22) from 75.3 per cent in 1998 to 63.5 per cent by the end of 2011.[[23]](#endnote-23) See Exhibit 2 for a summary of CN’s key financials for 2007–2011.

CP’s MANAGEMENT TEAM and board governance

Management Team

In 2006, CP announced the retirement of CEO Robert Ritchie after an 11-year term and appointed the then chief operating officer (COO), Fred Green, as the new CEO. Green had joined CP in 1978 and had progressed through the organization by assuming roles in operations, marketing, and sales.[[24]](#endnote-24) He had also served as an officer or director of many of CPRC’s former subsidiaries. In the six years since Green’s appointment, the remainder of CP’s management team had been described as a revolving door, with three different chief financial officers and five different COOs.[[25]](#endnote-25)

Board of Directors

CP’s board of directors’ mandate disclosed that “the Board is responsible for CP’s long-term strategic direction, succession plans for senior officers and risk management oversight.”[[26]](#endnote-26) At the end of 2011, CP’s board of directors consisted of 15 members, including current and former CEOs of publicly traded companies, railway industry veterans, and political leaders (see Exhibit 3). For example, board members included the former or current CEOs of some of Canada’s largest companies, such as the Royal Bank of Canada, Suncor Energy, and Shell Canada Limited. In addition, one-third of board members had been appointed Officers of the Order of Canada.[[27]](#endnote-27)

The CP board was considered long-tenured, with 60 per cent of members having served on the board longer than five years. In December 2011, the board appointed two railroad industry veterans as directors: Tony Ingram, the former COO of the CSX Corporation, and Ed Harris, the former COO of CP. Board governance documents indicated that the board could consist of no fewer than five members and no more than 20 members.[[28]](#endnote-28)

canadian corporate governance and shareholder activism

Corporate Governance

A company’s board of directors was charged with the overall governance and stewardship of the organization, and directors were appointed to act in the best interests of shareholders.[[29]](#endnote-29) By virtue of corporate and securities laws, shareholders of a corporation had the right to vote on a range of issues affecting the corporation, including the appointment of directors, appointment of auditors, and approval of certain fundamental changes or transactions. When organizations sought approval from shareholders on various proposals, they engaged in a process termed proxy solicitation to gather votes in advance of the annual general meeting of shareholders. Shareholders typically voted on these proposals by appointing another party to vote on matters on their behalf (a “proxy”), in order to streamline the process. The proposals were detailed within the company’s proxy circular, which included the relevant information required by shareholders in order to make an informed vote.

“Dissident” shareholders who wished to challenge management and propose alternative agendas could do so by engaging in a “proxy contest” to solicit votes from shareholders in their favour. In Canada, any shareholder with more than a 5 per cent share ownership of a certain voting class of a company’s equity could call a shareholder meeting and solicit proxies in support of their agenda.[[30]](#endnote-30)

Reporting Beneficial Ownership

Shareholders acquiring 10 per cent or more of a voting class of a Canadian company’s equity were required by the Securities Act to issue a press release announcing the acquisition and to file an “early warning” report within two days.[[31]](#endnote-31) Similarly, U.S. securities legislation required that shareholders file a Schedule 13D within 10 days of acquiring more than 5 per cent of a voting class of a company’s equity, while also reporting the transaction and providing a rationale for the acquisition.[[32]](#endnote-32) In Canada, shareholders were not required to disclose their intentions with respect to the ownership, creating potential uncertainty and unwelcome “surprises” for the company.

The Rise of Shareholder Activism

Activist shareholders could be defined generally as investors who purchased a large stake in a publicly traded organization with the intent to enact changes and realize a profit on the investment.[[33]](#endnote-33) The first notable wave of shareholder activism began in the United States in the 1980s with so-called “corporate raiders”[[34]](#endnote-34) taking advantage of depressed share prices and undervalued assets. By the early 1990s, companies had responded by introducing takeover defense mechanisms such as poison pills and golden parachutes, resulting in a decline in takeover activity.[[35]](#endnote-35)

Given the concentration of institutional investor share ownership among many Canadian companies, the level of shareholder activism in Canada paled in comparison to activities at U.S. organizations. Canadian institutional investors typically communicated displeasure by selling shares rather than initiating conflict.[[36]](#endnote-36) Notwithstanding, shareholder activism in Canada had gained traction in recent years as evidenced by the increasing number of proxy battles launched against Canadian companies. Approximately 101 proxy contests were completed in the five-year period ending December 31, 2012, representing an 84 per cent increase over the 55 contests completed in the prior five-year period.[[37]](#endnote-37)

This growth in shareholder activism and proxy contests in Canada could be partially attributed to activist-friendly legislation introduced in 2008, allowing eligible shareholders to solicit proxies without issuing a proxy circular.[[38]](#endnote-38) As such, shareholders could solicit proxies by simply issuing a press release or public announcement at any time prior to the proxy submission deadline (which could be as late as the eve of a shareholders’ meeting).

bill ackman and pershing square capital MANAGEMENT

William (Bill) Ackman graduated with an MBA from Harvard Business School in 1992. Upon graduation, he teamed up with Harvard classmate David Berkowitz to launch a hedge fund called Gotham Partners. With a passion for investing and US$3 million in start-up capital, the fund achieved significant success throughout the next six years, with annual returns of up to 40 per cent.[[39]](#endnote-39) Although the fund began by investing in relatively conservative opportunities, the pair became increasingly speculative and ran into trouble in the early 2000s. A highly leveraged investment in a money-losing golf course, combined with a probe into improper conduct by the U.S. Securities and Exchange Commission (SEC), forced the fund to wind down operations and sell off its assets in 2002.[[40]](#endnote-40)

Unfettered by the failure of Gotham Partners, Ackman launched a new hedge fund, Pershing Square Capital Management (Pershing), in 2004. Pershing was described as a research-intensive, fundamental value investor typically focusing on long-term, large-cap, and mid-cap companies.[[41]](#endnote-41) The fund’s style combined value investing and activist approaches to drive company share prices and improve fund performance. The bulk of Pershing’s portfolio was fairly concentrated, with the majority invested in consumer goods and consumer services businesses.[[42]](#endnote-42)

Over the next few years, Ackman garnered significant media attention by engaging in activist behaviour —that is, investing in companies and aggressively pursuing changes such as shifts in strategy or changes in management. In many cases, he succeeded in driving changes at his targeted companies with limited effort; however, not every activist investment made by Pershing proceeded according to plan. In 2007, Pershing established the “Pershing Square IV” fund and invested $2 billion in shares of retail giant Target Corporation, in order to enact changes in strategy and increase the share price. Although the company had partially implemented some of Pershing’s strategic recommendations, Pershing’s investment had fallen by 90 per cent by 2009, which Ackman described as one of the greatest disappointments of his career.[[43]](#endnote-43) When the company rejected further proposals by Ackman, he launched a proxy battle to appoint himself and four others to the board of directors; however, his bid was rejected by shareholders at the annual general meeting. Of the 24 companies Pershing had targeted for active investment, Target Corporation was only the second proxy battle initiated by Ackman (see Exhibit 4).[[44]](#endnote-44)

By 2012, Pershing had grown to over $11 billion in assets under management and employed 51 people. Since its inception, Pershing had delivered more than a 20 per cent annual compound rate of return to investors, approximately 90 per cent of which was generated based on activist plays.[[45]](#endnote-45)

A Stake in CP Rail

On October 28, 2011, Pershing filed a Schedule 13D with the SEC indicating that it had acquired 12.2 per cent of CP’s outstanding shares at an approximate cost of $1.07 billion.[[46]](#endnote-46) The filing also indicated that Pershing’s intent was to “engage in discussions with management, the board, other stockholders of [CP], and other relevant parties concerning the business, management, operations, assets, capitalization, financial condition, governance, strategy and future plans of [CP].”[[47]](#endnote-47) The acquisition made Pershing the largest single shareholder of CP shares.

In response to the filing, Cleghorn issued a memo to all CP employees on October 31, stating, “As with others, CP is open to the views of its shareholders. We will speak with Pershing Square to hear their input into our plan, already targeted at realizing greater efficiency and improved service reliability.”[[48]](#endnote-48)

initial correspondence and pershing square requests

After some initial phone calls, Ackman and Cleghorn decided to meet on November 2, 2011, to discuss Pershing’s investment objectives. During this meeting, Ackman focused heavily on CP’s past performance—specifically, the firm’s operating ratio. CP’s operating ratio was notably higher than most other Class I freight railroads and had been trending upward during Green’s tenure. By the end of 2011, CP’s operating ratio was the worst among its key competitors. Ackman asserted that the operating ratio could be reduced to the mid-60s by 2015, but only if a change in leadership occurred. Further, Ackman proposed that existing CEO Green be replaced by Hunter Harrison, the retired CEO of CP’s Canadian rival, CN. At the time, Cleghorn indicated that the board supported Green and CP’s existing strategy, and the two parties closed the meeting with limited resolution. Over subsequent communications in the days that followed, it became apparent that Ackman had two primary objectives: install Hunter Harrison as CEO and secure two seats on CP’s board of directors.

Hunter Harrison

Hunter Harrison had had an extensive career in the railway industry, beginning in 1964 as a carman-oiler for the [St. Louis–San Francisco Railway](http://en.wikipedia.org/wiki/St._Louis-San_Francisco_Railway). The Burlington Northern Railroad acquired the railway in 1980, and Harrison quickly progressed through the organization to the executive ranks. He was appointed CEO of the Illinois Central Railroad in 1993 and COO of CN when it acquired the Illinois Central Railroad in 1998. In 2003, he was appointed CEO of CN and remained in the position until his retirement on December 31, 2009. During his career, Harrison was named [Railroader of the Year](http://en.wikipedia.org/wiki/Railroader_of_the_Year) (2002, *Railway Age*), CEO of the Year (2007, *Report on Business*), Railroad Innovator (2009, Progressive Railroading), and International Executive of the Year (2009, *Canadian Chamber of Commerce*).[[49]](#endnote-49)

As part of his previous employment contract with CN, Harrison was bound by non-compete and non-solicitation agreements expiring December 31, 2011. In addition, his retirement and pension arrangements separately prohibited him from competing with CN until the end of 2014.[[50]](#endnote-50) Notwithstanding, Ackman was adamant that Harrison was the only candidate who could improve CP’s performance and help the company achieve its operating objectives.

Request for Board Seats

On November 4, 2011, Ackman contacted Cleghorn, requesting that the board provide Pershing with two seats on the board for him and a business partner, Paul Hilal. The board agreed to interview Ackman for a board seat, but declined to consider Hilal, given his lack of railway industry experience. This rationale was given despite a lack of railway experience among CP’s board members at the time. Following Ackman’s interview, the board extended him an offer to join the board; however, Ackman subsequently refused the offer due to a “standstill”[[51]](#endnote-51) agreement he was being asked to sign. On December 13, 2011, Pershing filed another Schedule 13D indicating that it had acquired further shares of CP, bringing its total holdings to 14.2 per cent of CP’s shares outstanding.

Canadian pacific goes public

On December 30, 2011, *The Globe and Mail* newspaper published an article titled “CP’s Activist Investor Eyes Former CN CEO Mr. Hunter Harrison.” The article represented the first public declaration of intent by Pershing to have Green replaced. In response to the article, Cleghorn publicized a letter addressed to Ackman on January 3, 2012, to reiterate the board’s commitment to Green and the company’s existing strategic plan. He refuted any rumours that the board was considering meeting with Harrison and emphasized the board’s commitment to engaging in continued dialogue with Pershing (see Exhibit 5).

Pershing square fires back

The following day, Ackman released his own public letter addressed to Cleghorn, countering the statements made by Cleghorn in his earlier letter. Specifically, Ackman asserted that Cleghorn had indicated that there was interest in meeting with Harrison, that the board was “forcing” Ackman to sign an exceptional contract in exchange for a seat on the board, and that Pershing did have a strong plan to improve CP’s operating performance. He closed by urging Cleghorn to meet with Harrison and board candidate Hilal as soon as possible (see Exhibit 5).

Early the following morning, Cleghorn received an e-mail from Ackman titled “War and Peace,” in which Ackman reiterated previous comments and provided an ultimatum: accede to his requests, or Pershing would launch a proxy contest at the next shareholders’ meeting. As part of this contest, Pershing was prepared to “take the largest public hall available and make a presentation to shareholders and the public about management and board failure over the past 10 years at CP.” His e-mail closed with a not-so-subtle threat: “Let’s avoid having a border skirmish turn into a nuclear winter. Life is too short.”[[52]](#endnote-52) The set of emails between Cleghorn and Ackman were fully reproduced by *The* *Globe and Mail* in its article of January 16, 2012. What came across in the emails was a sense of heightened emotions between Cleghorn and Ackman.

planning his next move

Cleghorn was faced with a dilemma. On the one hand, he could view the e-mail as an unfounded attack on the company, one that he needed to defend vigorously. On the other hand, he could view Ackman’s recommendations as having additional merit and as warranting more in-depth investigation. There were three potential courses of action. The choice made by Cleghorn and his board would be driven by their having to act in a manner consistent with the Canadian Business Corporations Act—to act in the best interests of the corporation. Taking such an action would be a clear expression that the board viewed their role as fiduciary agents of the corporation.

Agree to Ackman’s Proposal

One way to end the issue was to offer Ackman and Hilal two seats on the board (removing the standstill agreement) and commit to replacing Green with Harrison. If Cleghorn were to determine this was the optimal solution, then he was faced with how he would recommend these changes to the remaining board members and whether there was a business case to remove Green from the position of CEO. If he agreed to these changes, what else would Ackman push for once he was appointed as a board member? Was opening the doors to Ackman without certainty of his voting intentions the beginning of future boardroom battles?

Ignore Ackman and Maintain Existing Strategy

With a careful reading of the email exchange between Cleghorn and Ackman, it is reasonable to suggest that Cleghorn might consider that Ackman was bullying the board by using threats. Cleghorn, based on his most recent upbeat annual presentation to shareholders, demonstrated confidence in the company’s current strategic direction; thus, the question he had to consider was whether Ackman had a clear plan to implement the changes he sought. The company was a blue-chip Canadian company with a long and illustrious history, and hedge funds such as Pershing had to date largely ignored the Canadian marketplace. Therefore, a question that the board should consider was whether Ackman would give up the battle if Cleghorn and the board did not respond to this e-mail, or what other measures might be necessary to end his advances. Should Cleghorn return to the media and employ a tactic based on preserving Canadian firms to largely Canadian owners, and encourage other shareholders to push back against Ackman? Perhaps strength in numbers was all that was needed.

Continue Negotiations

Although recent conversations between Cleghorn and Ackman had been made public, one of the possibilities for Cleghorn in deciding the best course of action was to continue negotiating privately with Ackman in the hopes of swaying his opinion, or at the very least, reaching some form of compromise. What would be best for the corporation? Should Cleghorn, on behalf of the board, offer Ackman some other arrangement to appease his interests, while maintaining the stability of CP’s current management team?

With the knowledge that he should act in the best interests of shareholders, and that Pershing was CP’s largest shareholder, Cleghorn had to confront the challenge of determining how to prioritize these competing interests. With Ackman’s escalating threats and a shareholders’ meeting expected to occur in the next few months, time was not on Cleghorn’s side, and he needed to resolve this matter quickly.

Exhibit 1: Canadian Pacific railway KEy Financial Data (2009–2011)

(For years ending December 31, in CA$ millions)

|  |  |  |  |
| --- | --- | --- | --- |
|  | 2011 | 2010 | 2009 |
| Revenues | 5,052 | 4,853 | 4,280 |
| Operating income | 967 | 1,116 | 830 |
| Net income | 570 | 651 | 550 |
| Basic earnings per share (undiluted) | 3.37 | 3.86 | 3.31 |
| Free cash flow | (724) | (324.07) | (91) |
| Return on equity | 4.0% | 4.8% | 8.2% |

Source: Created by the authors.

Exhibit 2: Canadian National railway KEy financial data (2009–2011)

(For years ending December 31, in CA$ millions)

|  |  |  |  |
| --- | --- | --- | --- |
|  | 2011 | 2010 | 2009 |
| Revenues | 9,028 | 8,297 | 7,367 |
| Operating income | 3,296 | 3,024 | 2,406 |
| Net income | 2,457 | 2,104 | 1,854 |
| Earnings per share (undiluted) | $5.45 | 4.51 | 3.95 |
| Operating ratio | 63.5% | 63.6% | 67.3% |
| Operating cash flow\* | 2,976 | 2,999 | 2,279 |
| Return on equity | 23.0% | 18.6% | 16.5% |

Note: \* Not strictly comparable to Canadian Pacific Railway.

Source: Created by the authors.

Exhibit 3: Selected CP Board of Directors Biographies (as at december 31, 2011)

**John E. Cleghorn, O.C., F.C.A.;** Director since: October 2001

Mr. Cleghorn is the chairman of the board of directors of CP Rail. He is the retired CEO of the Royal Bank of Canada (1994–2001). He is a director of Molson Coors Brewing Company and a former chairman of the board of SNC-Lavalin Group Inc. He is governor emeritus of McGill University and chancellor emeritus of Wilfrid Laurier University. He was appointed an Officer of the Order of Canada in 2001.

**Tim W. Faithfull;** Director since: December 2003

Mr. Faithfull is the retired president and CEO of oil and gas company Shell Canada Limited (1999–2003). He is a director of TransAlta Corporation, AMEC Foster Wheeler plc, Canadian Natural Resources Limited, and Shell Pensions Trust Limited. From 1996 to 1999, he was chairman and CEO of Shell Singapore. He is a former member of the boards of Calgary Health Trust and The EPCOR Centre for the Performing Arts. He is also a trustee of the Starehe Endowment Fund (United Kingdom), and a council member of the Canada–UK Colloquium.

**Richard L. George;** Director since: May 2011

Mr. George is the president and CEO of Suncor Energy, an integrated energy company (1991–present). Mr. George is a member of the executive committee and board of directors of the Canadian Council of Chief Executives. He was inducted into the Canadian Petroleum Hall of Fame in 2008 and was appointed an Officer of the Order of Canada in 2007.

**Frederic J. Green;** Director since: May 2006.

**Edmond L. Harris;** Director since: December 2011

Mr. Harris served as executive vice-president and chief operations officer of CP from 2010 to 2011 and subsequently provided consulting services to CP. Mr. Harris served as the executive vice-president of operations for Canadian National Railroad (CN) and retired from CN in 2007. He joined the Illinois Central Railroad in 1968 and held various positions in operations there. Mr. Harris is currently engaged as senior advisor for Global Infrastructure Partners, an independent fund that invests in infrastructure assets worldwide.

**Tony L. Ingram;** Director since: December 2011

Mr. Ingram is the retired executive vice-president and COO of CSX Transportation Inc. He joined the Norfolk Southern Railway as a management trainee in 1970 and held various positions there, including labour relations officer, trainmaster, and superintendent, before moving into the general manager and vice-president ranks by 1993. The board of directors of CSX honored Mr. Ingram’s accomplishments by dedicating the company’s training centre in his name: the Tony L. Ingram Railroad Education and Development Institute. He was a director of Conrail, the Consolidated Rail Corporation, from 1999 to 2003 and is the former chairman of the Association of American Railroads’ Safety and Operations Management Committee.

**The Honourable John P. Manley, O.C.;** Director since: May 2006

Mr. Manley is president and CEO of the Canadian Council of Chief Executives (2010–present). From May 2004 to December 2009, he was counsel at the law firm McCarthy Tétrault LLP. His directorships include the Canadian Imperial Bank of Commerce, CAE Inc., and Optosecurity Inc. (a private company). In addition, Mr. Manley serves on the boards of the University of Waterloo, MaRS Discovery District, National Arts Center Foundation, CARE Canada, The Conference Board of Canada, and the Institute for Research on Public Policy. Mr. Manley has held various positions in the Canadian federal government, including member of Parliament for Ottawa South, deputy prime minister of Canada (2002–2003), minister of finance (2002–2003), minister of foreign affairs (2000–2002), and minister of industry.

Note: CP = Canadian Pacific Railway; CEO = chief executive officer; COO = chief operating officer

Source: Canadian Pacific, “Notice of Annual and Special Meeting of Shareholders and Management Proxy Circular,” May 12, 2011, accessed June 25, 2017 s21.qcdn.com/736796105/files-doc\_financials/Annual-Report/2011/cp-proxy-2011.pdf.

Exhibit 4: SAMPLE OF PERSHING SQUARE capital management’S ACTIVIST PLAYS

|  |  |  |
| --- | --- | --- |
| Target Company | Action | Outcome |
| Wendy’s International Inc. | * Acquired $5 million in shares and pushed for the company to spin-off its ownership of Tim Hortons Inc. | * Wendy’s International Inc. sold part of the Canadian chain to the public and the remaining to stockholders |
| McDonald’s Corporation | * Acquired call options on McDonald’s Corporation stock and encouraged other shareholders to push the company into selling the majority of its corporate-owned stores (through an initial public offer) and using the cash to repurchase shares | * Although McDonald’s Corporation refuted Ackman’s analysis and strategic plan, it eventually sold 1,500 of its underperforming stores to franchisees * Pershing sold its stake after two years, stating that its investment had nearly doubled |
| J. C. Penney Company Inc. | * As the company’s largest shareholder, Pershing received two board appointments and quickly encouraged the board to oust the existing CEO in favour of Apple Inc.’s retail chief, Ron Johnson | * Over the next few years, the company posted dismal results and the hiring of Johnson was considered a failure * Ackman resigned from the board after numerous public arguments with fellow board members * Estimated cost to Pershing: $700 million |
| General Growth Properties Inc. | * Pushed the company to file for bankruptcy in order to implement a restructuring plan | * The company filed for bankruptcy in 2009 and Pershing joined an investor group to reorganize the company * Pershing turned an investment of $60 million into $1.6 billion |
| Borders Group Inc. | * Invested and entered a loan agreement with the company as it attempted to sell the business | * Borders Group Inc. filed for bankruptcy after a failed merger attempt * Estimated cost to Pershing: $200 million |
| Ceridian HCM Inc. | * Invested and pushed company to replace its entire board and seek takeover bids | * A proxy contest ensued * The contest ended through a compromise—appointing four Pershing nominees to the board |
| Fortune Brands Home & Security | * After acquiring a large enough stake to become Fortune Brands Home & Security’s largest shareholder, Ackman proposed that the company be split into three separate businesses and that the less profitable business lines be sold | * The company agreed with Ackman, spinning off its home and security division, and selling its golf division * Pershing realized $500 million on the home division, and the remaining shareholdings increased significantly in value |
| Target Corporation | * Established a separate fund to bet on the rise of Target Corporation’s share price * Pushed for financial changes including selling credit card receivables and pursuing a stock buyback program | * Within two years, the value of Pershing’s investment had fallen by 90 per cent * Pershing launched a proxy battle to appoint four of its nominees to the board, but failed to gain shareholder votes at the meeting of shareholders |

Note: Pershing = Pershing Square Capital Management; all dollar amounts are in U.S. dollars;

Source: created by authors using date from “History,” BNY Mellon Pershing, accessed June 12, 2017, [www.pershing.com/about/history](http://www.pershing.com/about/history).

Exhibit 5: CP PUBLIC LETTER TO ACKMAN, JANUARY 3, 2012

Dear Mr. Ackman:

I have appreciated the dialogue between us and am optimistic that we can continue to discuss how to reach an agreement which advances the best interests of Canadian Pacific. However, on behalf of the Board of Directors of Canadian Pacific I am writing to express concern about recent media reports and to set the record straight regarding assertions attributed to “people familiar with the strategy of Mr. Ackman’s New York hedge fund Pershing Square Capital Management LP.” It is disappointing and highly inappropriate that Pershing Square made inaccurate comments in an article appearing in last Friday’s edition of The Globe and Mail (“CP’s activist investor eyes former CN CEO Hunter Harrison”) and to other media organizations in an effort to advance its own objectives. We are troubled by the inaccuracies and mischaracterizations that have appeared in the media.

Go to the link (<http://www.theglobeandmail.com/globe-investor/war-of-words-the-e-mails-that-touched-off-a-battle-at-cp/article1358767/?page=all/>) to read the entire letter.

Source: “War of Words; The Emails that Touched off a Battle at CP,” *Globe and Mail*, January 16, 2012, accessed June 12, 2017, https://theglobeandmail.com/globe-investor/war-of-words-the-e-mails-that-touched-off-a-battle-at-cp/article1358767/?ref=http://

www.theglobeandmail.com&page=all.

Pershing Square Public Letter to Cleghorn, January 3, 2012

Dear Mr. Cleghorn:

I write in response to your letter which I received from the press this morning. I too am troubled by inaccurate press reports about Canadian Pacific. To set the record straight, neither I nor any representative of Pershing Square has made any inaccurate statements to the press. Your letter, however, includes a number of statements that should be corrected so that Canadian Pacific’s stakeholders are fully apprised of the facts.

Go to the link (<https://beta.theglobeandmail.com/report-on-business/streetwise/ackman-fires-back-at-cp-the-full-letter/article620550/?ref=http://www.theglobeandmail.com&>) to read the entire letter.

Source: “Ackman Fires Back at CP: The Full Letter,” Globe and Mail, January 3, 2012, accessed June 12, 2017, https://theglobeandmail.com/report-on-business/streetwise/ackman-fires-back-at-cp-the-full-letter/article620550/?ref=http://

www.theglobeandmail.com&.

ENDNOTES

1. This case has been written on the basis of published sources only. Consequently, the interpretation and perspectives presented in this case are not necessarily those of Canadian Pacific Railway or any of its employees. [↑](#endnote-ref-1)
2. “War of Words; The Emails that Touched off a Battle at CP,” *Globe and Mail*, January 16, 2012, accessed June 12, 2017, www.theglobeandmail.com/globe-investor/war-of-words-the-e-mails-that-touched-off-a-battle-at-cp/article1358767/?page=all. [↑](#endnote-ref-2)
3. “Our History,” Canadian Pacific Railway, accessed February 23, 2014, www.cpr.ca/en/about-cp/our-history. [↑](#endnote-ref-3)
4. All currency amounts in the case are in Canadian dollars unless specified otherwise; CA$1 = US$0.97798 on January 1, 2012. [↑](#endnote-ref-4)
5. “Our History,” Canadian Pacific Railway, [op](http://op). cit. [↑](#endnote-ref-5)
6. Chris Sorensen, “CP’s Railway to Riches?,” *Maclean’s*, November 16, 2011. [↑](#endnote-ref-6)
7. “Rail in Canada 2009,” Statistics Canada, September 2011, accessed June 12, 2017, www.statcan.gc.ca/pub/52-216-x/2009000/part-partie1-eng.htm. [↑](#endnote-ref-7)
8. Canadian Pacific, *Annual Report 2011*, 9, accessed March 12, 2017, www.cpr.ca/en/investors-site/Lists/FinancialReports/cp-ar-2011.pdf. [↑](#endnote-ref-8)
9. John Cleghorn, Canadian Pacific Letter to Shareholders, January 9, 2012. [↑](#endnote-ref-9)
10. “About CP,” Canadian Pacific Railway, accessed February 23, 2014, www.cpr.ca/en/about-cp. [↑](#endnote-ref-10)
11. Transloading required shipments to be transferred from one mode of transportation to another (e.g., truck to rail). Intermodal transport used standard shipping containers to facilitate transfer across multiple modes of transportation without handling the freight itself, thereby reducing handling costs and improving delivery times. [↑](#endnote-ref-11)
12. Bulk commodity shipments for CP included grain, coal, sulphur, and fertilizers; Canadian Pacific, *Annual Report 2011*, op. cit. 12. [↑](#endnote-ref-12)
13. Barton Emmet Cramer, *North American Freight Rail: Regulatory Evolution, Strategic Rejuvenation, and the Revival of an Ailing Industry* (Iowa City, IA: University of Iowa, 2007). [↑](#endnote-ref-13)
14. “A Short History of U.S. Freight Railroads,” Association of American Railroads, April 2017, accessed June 12, 2017, www.aar.org/BackgroundPapers/A%20Short%20History%20of%20US%20Freight%20Railroads.pdf. [↑](#endnote-ref-14)
15. “Transportation Regulation,” Canadian Encyclopedia, accessed February 24, 2014, www.thecanadianencyclopedia.com/en/article/transportation-regulation. [↑](#endnote-ref-15)
16. “Overview of America’s Freight Railroads,” Association of American Railroads, April 2013. [↑](#endnote-ref-16)
17. Canadian Pacific was given a licence, by a Conservative government, to develop a cross-nation railroad and thus develop Western Canada, allowing grain farmers in the west to get their crops to market and manufacturers in Eastern Canada to get products to the west. In contrast, CN was the result of a Liberal government to put a group of largely bankrupt companies together as a national railroad, as a Crown Corporation, to compete with CP. [↑](#endnote-ref-17)
18. Crown Corporations were hybrid entities that were wholly owned by the government but operated as private enterprises in many respects. [↑](#endnote-ref-18)
19. CN Commercialization Act, S.C. 1995, c. 24, accessed June 12, 2017, http://laws-lois.justice.gc.ca/eng/acts/C-0.2/. [↑](#endnote-ref-19)
20. “CN’s Hunter Harrison Is the Recipient of Progressive Railroading’s ‘Railroad Innovator’ Award,” *Progressive Railroading*, September 2009, accessed February 23, 2014, www.progressiverailroading.com/canadian\_national/article/CNs-Hunter-Harrison-is-the-Recipient-of-Progressive-Railroadings-Railroad-Innovator-Award--21414. [↑](#endnote-ref-20)
21. Canadian National, *Annual Report 2011*, 13, accessed Mary 12, 2017, www.cn.ca/en/investors/reports-and-archives. [↑](#endnote-ref-21)
22. The operating ratio describes the company’s operating expenses as a percentage of revenue. A lower percentage indicates greater efficiency in operations. [↑](#endnote-ref-22)
23. Canadian National, *Annual Report 2000*, 2; Canadian National, *Annual Report 2011*, op. cit., 8. [↑](#endnote-ref-23)
24. “CPR’s CEO Rob Ritchie Retiring; COO to Succeed,” Canadian Shipper, March 1, 2006, accessed February 23, 2014, [www.canadianshipper.com/news/cpr-s-ceo-rob-ritchie-retiring-coo-to-succeed](http://www.canadianshipper.com/news/cpr-s-ceo-rob-ritchie-retiring-coo-to-succeed). [↑](#endnote-ref-24)
25. Bill Ackman, Pershing Letter to Shareholders, April 4, 2012, accessed June 12, 2017, http://www.visualwebcaster.com/Pershing/84724/files/Letter%20to%20Shareholders%20(English).pdf. [↑](#endnote-ref-25)
26. Canadian Pacific, Proxy Circular, 2012, 112 accessed March 12, 2017, http://s21.q4cdn.com/736796105/files/doc\_financials/Annual-Report/2012/cp-proxy-2012-supplement.pdf. [↑](#endnote-ref-26)
27. The Officer of the Order of Canada was administered by the Governor General of Canada on behalf of Her Majesty Queen Elizabeth II to recognize “a lifetime of achievement and merit of a high degree, especially in service to Canada or to humanity at large;” “Order of Canada,” The Governor General of Canada, accessed February 25, 2014, [www.gg.ca/document.aspx?id=14940](http://www.gg.ca/document.aspx?id=14940). [↑](#endnote-ref-27)
28. Canadian Pacific, Proxy Circular, op. cit., 120. [↑](#endnote-ref-28)
29. For a detailed overview of board of director obligations, see Murray J. Bryant and Ryan Kalt, *Note on Directors’ Duties and Obligations under Canadian Law and Custom* (London, ON: Ivey Publishing, 2008). Available from Ivey Publishing, product no. 9B08M042. [↑](#endnote-ref-29)
30. Peter M. Roth and Trevor R. Scott, “No Ordinary Shareholder Meeting: Shareholder Proposals, Requisitions, Proxy Contests and Stealth Proxy Campaigns,” *Lexpert/American Lawyer*,2011. [↑](#endnote-ref-30)
31. An exception to this requirement existed for eligible institutional investors, whereby they had up to 10 days following the month of acquisition to file a report. [↑](#endnote-ref-31)
32. Patricia L. Olasker and J. Alexandra Moore, *Proxy Contests: Issues and Trends* (Toronto, ON: Davies Ward Phillips & Vineberg LLP, October 1, 2013). [↑](#endnote-ref-32)
33. April Klein and Emanuel Zur, “Entrepreneurial Shareholder Activism: Hedge Funds and Other Private Investors,” (meeting paper, AAA 2007 Financial Accounting & Reporting Section [FARS], September 2006). [↑](#endnote-ref-33)
34. The term “corporate raider” was used to describe a person or persons purchasing significant stakes in companies with the intent to launch a hostile takeover or generate substantial investment returns in the process. [↑](#endnote-ref-34)
35. Poison pills enabled existing shareholders to purchase company shares at a discount, thereby diluting a raider’s interest and making a takeover bid more costly. Similarly, golden parachutes provided company executives with generous severance packages if control of the company changed. [↑](#endnote-ref-35)
36. Stephen I. Erlichman, “Canadian Institutional Investor Activism in the 21st Century: The Sleeping Giants Awaken,” *Queen’s Annual Business Law Symposium* (Kingston, ON: Queen’s University, October 2002). [↑](#endnote-ref-36)
37. Fasken Martineau DuMoulin LLP, *2013 Canadian Proxy Contest Study,* accessed March 12, 2017, www.fasken.com/en/canadian-proxy-contest-study\_e/. [↑](#endnote-ref-37)
38. “Proxy Battles: Canada’s Shareholder Friendly Legislation,” The Canadian Bar Association, accessed February 17, 2014, www.cba.org/CBA/PracticeLink/12-09-bc/12-09-bc\_5; and www.stockigloo.com/proxy-battles-canada%E2%80%99s-shareholder-friendly-legislation/. [↑](#endnote-ref-38)
39. “Pershing Square Capital Management,” accessed February 17, 2014, www.hedgefundletters.com/category/pershing-square. [↑](#endnote-ref-39)
40. Liana B. Baker, “If at First You Don’t Succeed, Start Another Fund,” *Reuters*, October 14, 2010, accessed February 17, 2014, [www.reuters.com/article/2010/10/14/us-hedgefunds-ackman-gotham-idUSTRE69D2OH20101014](http://www.reuters.com/article/2010/10/14/us-hedgefunds-ackman-gotham-idUSTRE69D2OH20101014). [↑](#endnote-ref-40)
41. “Willam A. Ackman,” CNBC, accessed March 12, 2017, www.cnbc.com/2015/03/24/william-a-ackman.html [↑](#endnote-ref-41)
42. “Bill Ackman’s Stock Portfolio: Every Holding Analyzed,” *Seeking Alpha*, April 19, 2017, accessed June 17, 2017, https://seekingalpha.com/article/4063280-bill-ackmans-stock-portfolio-every-holding-analyzed?page=2. [↑](#endnote-ref-42)
43. Pershing Square Capital Management was identified in 2012 as the 32nd largest hedge fund in the world, with $US10 billion assets under management, with assets in consumer and packaged goods, e.g., McDonalds and Proctor and Gamble; “The Hedgefund Journal,” Talking Hedge, accessed June 12, 2017, www.thehedgefundjournal.com. [↑](#endnote-ref-43)
44. Jacquie McNish, “ROB Magazine’s CEO of the Year: Bill Ackman,” *The Globe and Mail*, November 29, 2012. [↑](#endnote-ref-44)
45. Ibid. [↑](#endnote-ref-45)
46. Ibid. [↑](#endnote-ref-46)
47. Securities and Exchange Commission, Schedule 13D - y05282sc13d.htm, Issuer: Pershing Square Capital Management, October 28, 2011. [↑](#endnote-ref-47)
48. Scott Deveau, “Options for CP Include Asset Sale: Analysts,” *National Post*, November 1, 2011. [↑](#endnote-ref-48)
49. Bill Ackman, op. cit. [↑](#endnote-ref-49)
50. William C. Vantuono, “Will Hunter Harrison Reemerge—at CP?,” *RailwayAge*, January 15, 2012, accessed February 24, 2014, www.railwayage.com/index.php/freight/class-i/will-hunter-harrison-reemerge—at-cp.html. [↑](#endnote-ref-50)
51. The standstill agreement would require Ackman to vote all shares held by Pershing in favour of each of the board’s (director) nominees for election, and vote with the board’s recommendation with respect to any matter proposed by shareholders. [↑](#endnote-ref-51)
52. “Ackman and CP: The E-mail that Started it All,” *Globe and Mail*, January 14, 2013, accessed June 12, 2017, www.theglobeandmail.com/globe-investor/ackman-and-cp-the-e-mail-that-started-it-all/article4241432/. [↑](#endnote-ref-52)