****

**9B17M135**

**CANADIAN PACIFIC RAILWAY (B): CP RISING[[1]](#footnote-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.*

This publication may not be transmitted, photocopied, digitized, or otherwise reproduced in any form or by any means without the permission of the copyright holder. Reproduction of this material is not covered under authorization by any reproduction rights organization. To order copies or request permission to reproduce materials, contact Ivey Publishing, Ivey Business School, Western University, London, Ontario, Canada, N6G 0N1; (t) 519.661.3208; (e) cases@ivey.ca; www.iveycases.com.

*Copyright © 2017, Richard Ivey School of Business Foundation* *Version: 2017-09-08*

John Cleghorn, chair of the board of Canadian Pacific Railway (CP), was surprised by the market reaction to events stemming from the actions of Bill Ackmam, the chief executive officer (CEO) of CP’s largest shareholder, Pershing Square Capital Management (Pershing). The emails between Cleghorn and Ackman at first blush appeared conciliatory, but a careful reading by Cleghorn knew that was far from the truth, using the term war was unwarranted and almost insulting. It was February 6, 2012, and Cleghorn had just finished reading a report discussing investor confidence levels in CP’s management, and the results were not favourable. Tensions between CP and its shareholders had escalated ever since Ackman had threatened to launch a proxy contest five weeks earlier. Cleghorn wanted to ignore the recent confidence poll but wondered[[2]](#footnote-2) if his approach to protecting shareholder interests needed to change, given recent events.

Cleghorn’s response to “War and peace”

After receiving a not-so-subtle threat of a proxy battle from Ackman in an e-mail titled “War and Peace,” Cleghorn reached out to shareholders as quickly as possible to address Pershing’s accusations. Given that shareholder activism was a rare occurrence in Canada, there were limited precedents for how to respond. In consultation with fellow board members, Cleghorn issued a three-page letter to shareholders (see Exhibit 1) on January 9, 2012, in support of the company’s strategic plan and existing management team. Specifically, he addressed three key points:

1. The company was aggressively executing on its multi-year plan” and expected to achieve an operating ratio in the low 70s in the next three years.
2. Pershing did not have a credible improvement plan, and its stated objective of an operating ratio of 65 per cent for CP in 2015 was virtually impossible.
3. The company had carefully considered Pershing’s request to replace current CEO Fred Green with Hunter Harrison, the retired CEO of the Canadian National Railway (CN); however, the board unanimously agreed that this would jeopardize the successful execution of the multi-year plan” and was not in the best interests of shareholders.

In an interview with *Bloomberg* later that day, January 6, 2012, Ackman publicly disclosed Pershing’s intent to initiate a proxy contest for CP.

PErshing announces new director nominees

On January 24, Pershing issued a press release announcing a slate of five directors for election to the board of directors at CP’s annual shareholders’ meeting on May 17, 2012.[[3]](#footnote-3) The proposed directors included Ackman and business partner Paul Hilal, as well as seasoned business leaders with experience as executives or directors of various Canadian businesses.

In addition to announcing the director nominees, the press release reiterated Pershing’s intention to install Harrison as CEO. Since early January, Harrison had publicly supported Pershing’s agenda, stating, “I would be proud to help lead CP to victory. Should the board determine that I am the best candidate to lead the company, I would be honoured to serve.”[[4]](#footnote-4) This declaration was made despite a lawsuit initiated by CN against Harrison on January 23, which cited breaches of the non-compete provisions in his contract owing to his involvement with Pershing. Following the lawsuit filing, CN suspended payment of Harrison’s pension and certain other benefits valued at approximately CA$40 million.[[5]](#footnote-5) Ackman responded by confirming that Pershing would indemnify Harrison against any losses arising from the lawsuit, including guaranteeing his pensions and benefit payments. One week later, Harrison purchased $5 million worth of CP stock with his personal funds.

PERSHING HOLDS INVESTOR TOWN HALL

On January 30, Pershing announced its intention to host a town hall meeting for CP investors and other interested parties. The meeting would include a presentation by Ackman, Hilal, and Harrison, and each of Pershing’s director nominees would be in attendance. Pershing followed through by hosting a “CP Rising” town hall in Toronto on February 6, in front of 350 shareholders, analysts, and media personnel, and an additional 1,000 viewers via an online webcast.

After a brief introduction by Ackman at Pershing’s town hall meeting, Hilal presented a series of slides highlighting CP’s performance over the past six years. Specifically, Pershing blamed CP’s poor performance on “substandard service” levels limiting pricing power, as well as rising unit costs. Further, CP was also accused of overpaying for its 2007 acquisition of the Dakota, Minnesota and Eastern Railroad, resulting in poor cash flow and productivity. Following the presentation on the perceived failings of CP’s board and management team, Ackman “interviewed” Harrison for the role of CEO at CP. During the discussion, Harrison was not shy about his accomplishments and commitment to improving CP, stating that if he could not deliver results, “You can hang me in Times Square and pay me nothing.”[[6]](#footnote-6) His strategy was clear—implement precision railroading in the same manner as he had done at CN to enhance operational efficiency. Precision railroading would require CP to focus on enforcing stringent train schedules, thereby reducing idle time and maximizing the utilization of its trains. The downside of this strategy was the potential for trains to depart with or without the required cargo and/or delivering shipments when other parties in the supply chain (e.g., boats) were not prepared to take them. Although CP’s role in the supply chain would be highly precise, the potential for subsequent delays and missed cargo could upset customers.

After the town hall meeting, CP management issued a letter to CP employees updating them on CP’s progress against the multi-year plan and countering statements made by Pershing during the event, suggesting that CP management believed that Pershing had presented a series of inaccuracies. No further public statements were made by CP.

WANING INVESTOR SUPPORT

On February 16, consulting firm Brendan Wood International (Brendan Wood) released a special report for CP shareholders outlining its findings with respect to investor confidence levels in the firm. Based on Brendan Wood’s study, confidence in CP’s senior management ranked in the bottom 5 per cent among the 41 firms in Brendan Wood’s Global Transportation Index.[[7]](#footnote-7) While the poll did not necessarily reflect the views of CP shareholders, it provided an indication of the sentiment among equity market participants (see Exhibit 2). Since the beginning of the year, Cleghorn had met with various CP shareholders and analysts to discuss the speculation regarding Pershing’s proposal, and feedback from shareholders had been discussed at the board level.

STAY THE COURSE?

Despite the Brendan Wood report, Cleghorn’s personal conversations with CP shareholders indicated that confidence in the firm’s strategy and management team remained positive. Indeed, a long-time CP customer and shareholder criticized Ackman at his town hall for leading “a terrible forum because it’s been so one-sided.”[[8]](#footnote-8) Notwithstanding, Ackman’s behaviour received significant media attention and was an unwelcome distraction to the company at a time when it needed to maintain focus on operations. Cleghorn had a clear choice, to continue to defend CP’s existing approach, or call a truce with Ackman. If he chose the latter, what would the compromise be?

EXHIBIT 1: EXCERPTS FROM CP LETTER TO SHAREHOLDERS, JANUARY 9, 2012

CP’s multi-year plan has three key elements—driving volume growth, expanding network capacity to safely and efficiently support higher volumes and controlling costs. CP’s management team is aggressively executing on the company’s multi-year plan and has the full support of the board of directors. . . .

The board is confident in CP’s ability to reach an operating ratio (“OR”), or operating expenses as a percentage of revenue, in the low 70s in the next three years. We will not stop there—as we achieve our goals, we will set new targets. . . .

The board takes all suggestions from shareholders seriously and has carefully considered Pershing Square’s demand that CP replace the company’s chief executive officer with Hunter Harrison…. the board came to the unanimous conclusion that replacing the company’s chief executive officer… is not in the best interests of CP or its shareholders. . . .

Pershing Square stated that Mr. Harrison would only begin to develop a detailed plan over a number of months. Despite the absence of a credible, detailed plan, Pershing Square has stated to CP that an improvement in OR from 78 in 2010 to 65 in 2015 is achievable. This pace of improvement, from this starting point, has never been achieved by any railway management team. . . .

As Ed Harris, who has served as EVP of Operations for both CP and CN, has told the Board, “It is a mistake to underestimate the differences between the infrastructure of CP and CN. On the one hand, in CN you have a railroad that was built by Canadian taxpayers with twice the proportion of sidings and double track and that therefore benefits from significantly enhanced operating flexibility. On the other hand, CP has to contend with greater geographic challenges. I am pleased to see significant improvement in CP’s operating metrics as a result of planned initiatives.”. . .

The board’s overriding responsibility is to act in the best interests of the company, and we believe that Pershing Square’s repeatedly stated agenda of management change would be detrimental to the company and its shareholders. . . .

We reiterate our offer to have Mr. Ackman join our board so that a constructive board-level dialogue based on all the relevant facts and information can commence.

Note: CP = Canadian Pacific Railway; Pershing Square = Pershing Square Capital Management; EVP = executive vice-president; CN = Canadian National Railway

Source: “CP Executing on Clear Plan to Achieve Low 70s Operating Ratio as Quickly and Efficiently as Possible,” Cision PR Newswire, January 9, 2012, accessed June 12, 2017, www.prnewswire.com/news-releases/cp-executing-on-clear-plan-to-achieve-low-70s-operating-ratio-as-quickly-and-efficiently-as-possible-136933158.html?.

EXHIBIT 2: BRENDAN WOOD INTERNATIONAL SURVEY RESULTS

|  |  |
| --- | --- |
| **Shareholder Confidence Driver** | **Canadian Pacific Railway Ranking**  **(Out of 41 Companies)** |
| Senior Management | 40th |
| Chief Executive Officer | 38th |
| Acquisition Capability/Balance Sheet | 38th |
| Strategy | 33rd |
| Chief Financial Officer | 32nd |
| Board | 28th |
| Long-Term Growth Potential | 15th |
| Short-Term Growth Potential | 13th |
| Disclosure | 10th |
| Upward Potential of Stock | 5th |

Source: “Shareholder Confidence Problems Back Ackman’s Challenge of CP Management,” TopGun Press, February 16, 2012, accessed June 13, 2017, http://topgunpress.com/shareholder-confidence-issues-back-ackmans-challenge-of-cp-management/.

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. [↑](#footnote-ref-1)
2. Letter to shareholders, released January 9, 2012, by CP, reprinted in full in “Canadian Pacific Defends its CEO, Largest Shareholder to Wage Proxy Battle,” *Calgary Herald*, January 9, 2012, accessed June 25, 2017, <http://calgaryherald.com/business/canadian-pacific-defends-its-ceo-largest-shareholder-to-wage-proxy-battle>; as of June 25, 2017, the letter had been withdrawn from CP’s website. [↑](#footnote-ref-2)
3. Pershing had sent CP a requisition for a special meeting of shareholders but withdrew the request when CP announced the annual shareholders’ meeting date. [↑](#footnote-ref-3)
4. “Pershing Square Announces Nominees for Election to the Board of Directors of Canadian Pacific Railway,” Pershing Square Press Release, Cision, January 24, 2012, accessed August 4, 2017, www.newswire.ca/news-releases/pershing-square-announces-nominees-for-election-to-the-board-of-directors-of-canadian-pacific-railway-509481021.html. [↑](#footnote-ref-4)
5. All currency amounts in the case are in Canadian dollars unless specified otherwise; CA$1 = US$0.97798 on January 1, 2012. [↑](#footnote-ref-5)
6. “Driving Change. Building Value,” Town Hall Meeting Webcast (Video Replay), Pershing Square Capital Management, February 6, 2012. [↑](#footnote-ref-6)
7. The study gathered opinions from over 2,000 investors and advisors in the investment industry with respect to 10 core-buying criteria for 41 transportation companies. Results were aggregated in an index and CP’s results were reviewed relative to the index. [↑](#footnote-ref-7)
8. J. Nelson, “A New Wave of Activism,” *Canadian Business*, March 5, 2012. [↑](#footnote-ref-8)