****

9B17N024

UNLOCKING VALUE AT CANADIAN PACIFIC: THE PROXY BATTLE WITH PERSHING SQUARE[[1]](#footnote-1)

Ken Mark wrote this case under the supervision of Chris Makuch and Professors Stephen Foerster and W. Glenn Rowe 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*](mailto:cases@ivey.ca)*;* [*www.iveycases.com*](http://www.iveycases.com)*.*

Copyright © 2017, Richard Ivey School of Business Foundation Version: 2020-06-26

It was May 2, 2012, and Susan Smith at GBR Capital, a hedge fund based in New York, was thinking about how she should vote her fund’s shares at Canadian Pacific’s (CP’s) upcoming annual shareholders’ meeting in two weeks in Calgary, Alberta. CP had built the country’s first transcontinental railroad in the 19th century. Its board of directors was the target of a proxy battle for control of the firm initiated by Pershing Square Capital Management, L.P. (Pershing Square) in March 2012.

Both CP and Pershing Square had made presentations to proxy advisors Glass Lewis and Institutional Shareholder Services (ISS). Proxy advisors provided voting recommendations to clients such as private funds and institutional investors. As part of their analysis, the proxy advisors received information from management and from the dissident shareholder, Pershing Square. Due to the lack of voting direction by management and CP’s high level of institutional ownership, Smith believed that the recommendations of proxy advisors would be key in the proxy contest, but she also needed to perform her own analysis of the intrinsic value of CP shares under the scenario of the status quo with CP’s current management and strategy in place versus a potential shakeup, as suggested by Pershing Square.[[2]](#footnote-2)

One statement in Pershing Square’s dissident presentation, which had been sent out on January 24, 2012, stood out for Smith: “Canadian Pacific is 70 per cent the size of Canadian National, yet has an enterprise value 40 per cent as large, due to its inferior profitability and asset utilization.”

Class I North American Railroads

Railroad companies were ranked by revenues, with Class I railroads being the biggest and Class III railroads the smallest. In the United States, a Class I railroad had at least US$250 million in sales; in Canada, a Class I railroad had at least CA$250 million in sales.[[3]](#footnote-3)

The United States and Canada had six Class I railroads: Union Pacific, CSX, Norfolk Southern, Canadian National Railway (CN), CP, and Kansas City Southern (plus BNSF, a wholly owned subsidiary of Berkshire Hathaway). Rail was an integral part of the transportation network in North America for goods, grains, and commodities. For example, more than two-thirds of U.S. coal was carried by rail. Rail was typically used as part of intermodal operations, facilitated by the use of standardized containers that could be moved from trucks to rail to ships.

The single most important measure of profitability in the railroad industry was the operating ratio, defined as the firm’s operating expenses as a percentage of its total revenues. A lower operating ratio was desirable, and firms targeted operating ratios below 80, with a figure in the mid-70s being more desirable. Components of these operating expenses included major categories such as labour, materials, fuel, and depreciation. Of operating expenses, labour could account for more than a third and fuel could account for a fifth.[[4]](#footnote-4)

Operating ratios at these six major railroads had improved as non-core infrastructure was divested, investments were made in more efficient equipment, and new operating procedures were adopted. For example, CN’s operating ratio declined to 63.6 per cent in 2010 from 97.1 per cent in 1992. Over the same period, CP’s operating ratio dropped to 77.6 per cent from 95.9 per cent (see Exhibit 1).

**Canadian Pacific Railway**

The Canadian Pacific Railway was incorporated on February 16, 1881, with the intent of building a transcontinental railway in Canada. As a condition of joining Canada’s confederation in 1867, Nova Scotia and New Brunswick were promised rail links with Quebec and Ontario. But government mismanagement resulted in little progress on the project, until a group of businessmen founded CP. A century later, in 1986, CP was the nation’s second-largest firm, with $15 billion in revenues, and had become a conglomerate, with subsidiaries in energy, commodities, hotels, and ships. With the goal of unlocking shareholder value, Canadian Pacific’s parent company spun out its five subsidiaries—CP, Pan Canadian Energy, Fording Coal, CP (later Fairmont) Hotels, and CP Ships—into separate companies on October 3, 2001.

CP had a 14,700-mile (23,657-kilometre) network of railroads and intermodal transportation links from the Port of Vancouver in Canada’s West to the Port of Montreal in Canada’s East, and to the U.S. industrial centres of Chicago, Newark, Philadelphia, Washington, New York City, and Buffalo.[[5]](#footnote-5) This network transported bulk commodities, merchandise freight, and intermodal traffic. In 2011, CP’s strategic goal was to “become the safest, most fluid railway in North America,”[[6]](#footnote-6) focusing on five areas: service, safety, productivity and efficiency, people, and growth.

CP’s board included members of the country’s business elite. For example, John Cleghorn was the former chairman and chief executive of the Royal Bank of Canada, the country’s largest financial services company.[[7]](#footnote-7) Frederic J. Green had been the firm’s chief executive officer (CEO) since 2006 (see Exhibit 2).

CP faced a challenging first six months in 2011, as a result of disruptions to its operations due to severe winter weather and flooding. These delays limited the speed at which its trains could travel, and productivity had suffered. The firm worked in the second half of 2011 to restore service and its reputation for customer focus. Management stated:

Despite these challenges, we were able to complete our planned capital program in 2011. Our continued work on building new sidings and extending our current ones to support our long-train strategy paid dividends; CP set a new full-year record in train weights in 2011. In addition, we set full year records in both terminal dwell and car miles per car day as a result of implementing our First Mile-Last Mile program in Canada. We expect further improvements as we continue to tighten standards in Canada and roll out the program in the U.S. We completed the second phase of our Locomotive Reliability Centre strategy, which will reduce the number of major locomotive repair facilities from eight to four highly efficient super shops with improved repair capabilities. These improved efficiencies will allow us to do more with less and to reduce our asset pools and associated costs.

CP has signed several commercial agreements with customers, terminal operators and ports that will drive improvements in supply chain performance. In early 2012, we announced a new five-year agreement with Canadian Tire and a ten-year agreement with Canpotex. In addition, CP has worked with its customers, leveraging technology to enhance car request management and implementing new productivity tools. Our scheduled grain program has been successfully implemented in Canada and the U.S. program will be implemented by August 2012. We are also developing new volumes of Powder River Basin coal for export off the west coast of British Columbia.[[8]](#footnote-8)

In 2011, CP’s accomplishments included

* Managing overall indebtedness by repaying US$246 million of maturing 2011 debt and by calling US$101 million of 2013 debt;
* Making a $600 million voluntary prepayment to its main Canadian defined benefit pension plan; and
* Delivering consistent dividend growth by increasing its quarterly dividend to common shareholders by 11 per cent, from $0.27 to $0.30 in 2011.[[9]](#footnote-9)

CP announced a goal of bringing its operating ratio down to the range of 70–72 per cent for 2014, and continued improvement beyond 2014.[[10]](#footnote-10) It aimed to reduce the operating ratio to the range of 68.5–70.5 per cent by 2016. According to CP’s position, much of the difference in operating ratios compared with other railroads was due to external factors such as legacy pension costs; tighter curves and steeper grades that required slower speeds and more locomotives, respectively; and greater competition along its routes.

Between April and September 2011, the trading price of CP’s common shares declined from approximately $63 per share to a low in late September of just below $49 per share. CP’s stock price performance for the 10-year period 2002 to 2012 was roughly similar to a Toronto Stock Exchange index, but fared much lower than CN’s performance (see Exhibit 3).

**Pershing Square Capital Management**

With a corporate partner, Leucadia National, William Ackman founded Pershing Square Capital Management (Pershing Square), a hedge fund, in 2004 with US$54 million of his own capital. Pershing Square was known for taking large positions in targeted firms and being actively engaged in their management. Recent activist campaigns included Target Corp., Canadian Tire, Wendy’s (forcing the company to spin-off Tim Hortons), and most recently J.C. Penney.

Ackman’s track record included successes and failures. After a months-long debate between Target Corp.’s management and Ackman, shareholders voted down Ackman’s effort to gain board representation at their annual meeting in Waukesha, Wisconsin. In a preliminary tally of voting, more than 70 per cent voted in favour of the company’s proposed slate of directors, and the same margin voted to keep the size of the board the same. Target Corp. had urged its shareholders to vote in favour of a proposal to set the size of the board at 12 and to vote for the company’s nominees.[[11]](#footnote-11)

In a regulatory filing released October 28, 2011, Pershing Square indicated it owned an aggregate 20.7 million common shares (which included 2.65 million common shares underlying a call option) representing 12.2 per cent of CP’s outstanding common shares. The firm had begun buying CP shares in September 2011, investing $1.1 billion in total for an average price of $54.46 per common share. Pershing Square’s intent, according to the filing, was to discuss with CP’s management, its board, and other shareholders ways in which the business could be improved.

Ackman’s chief recommendation was to install Hunter Harrison as CP’s new CEO. With an established track record as CN’s chief operating officer and then its CEO, Harrison had a reputation for improving CN’s productivity and profits. He had reduced staff levels and introduced the concept of precision railroading, which involved putting operations on a strict schedule. His drive for efficiencies had even led to the implementation of penalties for customers who did not load or unload their freight on time.

**The Role of Boards**

A board of directors was generally accepted as being necessary to manage the agency relationship created by the separation of ownership and management, and was a legal requirement for incorporation. A board was ultimately responsible to the shareholders for all aspects of the corporation, but would delegate most of the operating responsibility to professional management. Thus, in any firm, a board had specific responsibility for hiring, performance evaluation, compensation, and succession of the CEO. A board might also choose to require management to obtain the board’s specific approval before proceeding with certain types of initiatives such as strategic changes, major financial commitments, and significant acquisitions. In those areas, management was responsible for initiating proposals and implementing board-approved decisions; the board of directors was responsible for choice among and/or ratification of management recommendations, and monitoring their implementation by management.

From a corporate governance perspective, boards were being encouraged[[12]](#footnote-12) to re-evaluate the meaning of the phrase in the *Canadian Business Corporations Act* (see Item 122 (1) (a), page 88) “act honestly and in good faith with a view to the best interests of the Corporation.”[[13]](#footnote-13) One perspective was that it meant in the best interests of the shareholders, commonly known as the shareholder primacy norm. A second perspective was that it meant in the best interest of all stakeholders, which was known as the plurality perspective. This view included shareholders, debtors, communities, provincial and federal governments, the environment, customers, suppliers, employees, managers, members of boards, and other stakeholders. A third perspective was that the corporation was viewed as a legal entity in and of itself and that the phrase literally meant in the best interests of the corporation as a legal entity. According to this perspective, boards could make decisions that would sustain the corporation and be to the detriment of all other stakeholders, including shareholders and debtors.

**The Timeline[[14]](#footnote-14)**

In late September 2011, funds controlled by Pershing Square began acquiring common shares of CP at prices of approximately $50 a share, approximating the two-year low in CP’s trading price. By October 18, 2011, Pershing Square had acquired more than 5 per cent of the outstanding CP shares, prompting an obligation to file a Schedule 13D report with the Securities Exchange Commission in the United States, where its stock was listed for trading. By the time that report was filed on October 28, 2011, Pershing Square’s interest exceeded 10 per cent, resulting in an obligation to file an early warning report with securities regulators in Canada where its stocks were also listed for trading, which ultimately was filed five days later. Pershing Square disclosed in those reports its belief that CP’s shares were undervalued and that it was engaging in discussions with management, the board, and other shareholders regarding CP.

Subsequent negotiations between CP’s board and Pershing Square broke down and by early January 2012, the two sides were entrenched in their positions, and the public was aware that a proxy battle was imminent. CP’s board decided to address its investors and the public by publishing an Open Letter to Pershing Square on January 3, 2012. In it, CP’s board aimed to correct what it felt were inaccurate comments by Pershing Square and reiterated CP’s invitation for Ackman to join its board, subject to a few restrictions. Ackman’s response, provided in an Open Letter to CP on January 9, 2012, indicated that Pershing Square felt its media statements were accurate. He went on to assert that Pershing Square intended to transform CP’s culture and operations with the goal of turning it into one of the best railroads in North America. Ackman also defended his decision to put forth Harrison as CP’s new leader. Pershing Square’s nominees for the board included three independent Canadian business leaders (see Exhibit 4).

Pershing Square sent a requisition for a shareholder meeting to CP on January 23, 2012, but when CP later that same day announced that its annual meeting would be held on May 17, 2012, Pershing Square withdrew its requisition. Pershing Square filed a dissident information circular on January 24, 2012, and began holding public investor meetings to build support. CP filed its proxy circular on March 22, 2012, and began holding its own public investor meetings. Various proxy battles followed, intended to gather enough shareholder votes to win corporate votes (see Appendix 1).

**Smith Gathers Information for her Review**

Smith supplemented her analysis with an overview of current economic conditions. She noted that the Government of Canada’s benchmark 10-year bond had a yield of 1.79 per cent at the end of April 2012.[[15]](#footnote-15) In Canada, real gross domestic product was expected to achieve annual growth of 2 per cent in 2012, and then increase to an average annual growth rate of 2.2 per cent between 2013 and 2016. Canadian exporters were forecast to be negatively affected by a slowdown in the Euro zone and China, and the Canadian dollar was expected to be at or around parity to the U.S. dollar until 2016. In the United States, the economy was in the midst of a broad-based recovery, with the unemployment rate trending downward. The United States was expected to grow at a slightly faster pace—2.3 per cent per year from 2013 to 2016 (see Exhibit 5) as real private consumption rose and as exports grew, especially to emerging markets.

What Smith read about Ackman’s public statements seemed to provide reassurance that he did not want to take over the entire board:

Pershing Square—What a vote for the Nominees for Management Change (NMC) does NOT mean: Not a change of control; NMC will be five of 13 or 15 directors. Pershing Square would have two of 13 or 15 Board seats (proportionate to ownership). The entire, refreshed Board will make the CEO hiring decision.[[16]](#footnote-16)

In contrast, she sensed frustration on Green’s part when he stated that bringing Harrison’s management methods was counter to the culture he was trying to build at the firm. Green stated:

You can work your way across the breadth of stakeholders, whether it’s communities, governments, customers or shareholders, people see the risk attached to this proposal. The venom that exists in the shipper community towards the dismissive attitude that Mr. Harrison brought to the marketplace is what it is.[[17]](#footnote-17)

CP’s income statements, balance sheets, and cash flow statements provided Smith with a great amount of financial information (see Exhibits 5, 6, and 7, respectively). Smith also read that some believed it would be difficult for Harrison to transfer his methods from CN to CP. First, CP’s railroads traversed tougher terrain in contrast to the easier routes taken by CN. Second, CP had higher labour costs and was in discussions with its union to improve productivity, including implementing a 12-hour workday and new rules on vacations. The Teamsters union represented 4,800 CP conductors, engineers, and rail traffic controllers.[[18]](#footnote-18) To show his interest in the top job, Harrison had purchased $5 million worth of CP shares earlier in 2011.[[19]](#footnote-19)

Ackman believed that despite the differences between CN and CP, the latter could be more profitable, arguing that under Harrison’s leadership it could achieve an operating ratio of 65 per cent by 2015.[[20]](#footnote-20) Green countered, insisting that an adversarial attitude would be unproductive, as 80 per cent of its business was subject to direct competition.

The Oliver Wyman Group, an independent consultant hired by CP to gauge the feasibility of both plans, concluded that Harrison’s target was “not possible,” whereas CP’s was both “reasonable and achievable” and also took into consideration the steeper grades and greater curvature of CP’s network, which the consultant estimated that it would add about 6.7 per cent to its operating ratio. “Curves and grades [are] physics, and the dismissive comments by Harrison indicate a clear lack of research or understanding, or both,” Green said.[[21]](#footnote-21)

**Smith Estimates CP’s Value**

Smith at GBR Capital wanted to value CP’s shares based on the status quo and current management versus Hunter Harrison as CEO, implementing a cost-cutting program (for simplicity, as of December 31, 2011). In doing this valuation, Smith needed to develop two sets of projected cash flows and review information on comparable railroads. She created a set of estimates that included the status quo and a more optimistic forecast that assumed Harrison would become CEO and implement a new strategy. The status quo forecast—from 2012 to 2016—would have revenues at $5.6 billion in 2012 and rising 4 per cent per year. The operating ratio would start at 80 per cent and decrease to 76 per cent by 2016. Depreciation would start at $600 million, and capital expenditures, at $1.1 billion. Both figures would rise by $25 million each year.

The more optimistic forecast included revenue projections that also started at $5.6 billion in 2012 and rose by 5 per cent per year. The operating ratio would start at 76 per cent and decrease to 68 per cent by 2016. Her estimate of depreciation expenses would not change. She estimated capital expenditures in 2012 at $1 billion, rising by $25 million a year, reflecting the conjecture that Harrison would be focused on cutting costs and investing capital more efficiently. Smith gathered comparative information on competitive firms (see Exhibit 9). She contemplated how best to use this information to estimate intrinsic values under the two scenarios.

Smith planned to estimate intrinsic values using a discounted cash flow approach as well as relative valuations. She assumed a tax rate of 25 per cent. She planned to use the capital asset pricing model to estimate the cost of equity, using a risk-free rate of 1.79 per cent, a beta of 1.3, and an expected market risk premium of 5.0 per cent. CP’s before-tax cost of debt was 6 per cent. Smith ignored any changes in working capital, which she assumed would not be material. Under both scenarios, Smith assumed a growth of free cash flows beyond the next five years at 2 per cent. She also pondered what kind of return equity investors might garner over a five-year horizon under the two scenarios, assuming Pershing Square’s average acquisition price.

In the short term, Smith faced the proxy vote decision. She needed to send in GBR Capital’s votes on behalf of her fund. While her main aim was to make a decision that would maximize value for GBR Capital’s investors, Smith also questioned the extent to which her decision should factor in CP’s corporate governance issues.

**Exhibit 1: CaNadian pacific AND Canadian national railway financial performance and OPERATING RATIOS, 2007–2011 (in CA$ millions)**



Source: Canadian Pacific, *2007 Annual Report,* accessed July 23, 2017, http://s21.q4cdn.com/736796105/files/doc\_financials/Annual-Report/2007/AR2007.pdf; Canadian Pacific, *2008 Annual Report*, accessed July 23, 2017, http://s21.q4cdn.com/736796105/files/doc\_financials/Annual-Report/2008/AR2008.pdf; Canadian Pacific, *2009 Annual Report,* accessed July 23, 2017, http://s21.q4cdn.com/736796105/files/doc\_financials/Annual-Report/2009/AR2009.pdf; Canadian Pacific, *2010 Annual Report*, accessed July 23, 2017, http://s21.q4cdn.com/736796105/files/doc\_financials/Annual-Report/2010/AR2010.pdf; Canadian Pacific, *2011 Annual Report,* accessed July 23, 2017, http://s21.q4cdn.com/736796105/files/doc\_financials/Annual-Report/2011/AR2011.pdf; Canadian National Railway Company, *2007 Annual Report,* accessed July 23, 2017, https://docs.google.com/viewer?url=http%3A%2F%2Fwww.cn.ca%2F-%2Fmedia%2FFiles%2FInvestors%2FInvestor-Annual-Report-Archive%2FEnglish%2F2007-CN-Annual-Report.pdf%3Fla%3Den; Canadian National Railway Company, *2008 Annual Report,* accessed July 23, 2017, https://docs.google.com/viewer?url=http%3A%2F%2Fwww.cn.ca%2F-%2Fmedia%2FFiles%2FInvestors%2FInvestor-Annual-Report-Archive%2FEnglish%2F2008-CN-Annual-Report.pdf%3Fla%3Den; Canadian National Railway Company, *2009 Annual Report,* accessed July 23, 2017, https://docs.google.com/viewer?url=http%3A%2F%2Fwww.cn.ca%2F-%2Fmedia%2FFiles%2FInvestors%2FInvestor-Annual-Report-Archive%2FEnglish%2F2009-CN-Annual-Report.pdf%3Fla%3Den; Canadian National Railway Company, *2010 Annual Report,* accessed July 23, 2017, https://docs.google.com/viewer?url=http%3A%2F%2Fwww.cn.ca%2F-%2Fmedia%2FFiles%2FInvestors%2FInvestor-Annual-Report-Archive%2FEnglish%2F2010-CN-Annual-Report.pdf%3Fla%3Den; Canadian National Railway Company, *2011 Annual Report,* accessed July 23, 2017, https://docs.google.com/viewer?url=http%3A%2F%2Fwww.cn.ca%2F-%2Fmedia%2FFiles%2FInvestors%2FInvestor-Annual-Report-Archive%2FEnglish%2F2011-CN-Annual-Report.pdf%3Fla%3Den.

**Exhibit 2: Frederic J. Green and CanadiaN pacific Board of directors**

Green has served as the chief executive officer at Canadian Pacific Railway Limited since May 5, 2006, and as its president since November 1, 2005. He served as the chief operating officer at Canadian Pacific Railway Limited, and held various positions in operations and marketing since 1978.

**Canadian Pacific Board of Directors**

John E. Cleghorn—Cleghorn is the chairman of the board of directors. He is the retired chief executive officer of the Royal Bank of Canada. He is a director of Molson Coors Brewing Company, and chairman of the board of SNC-Lavalin Group Inc. from May 2002 until May 2007.

Tim W. Faithfull—Faithfull is the retired president and chief executive officer of Shell Canada Limited, an oil and gas company. He held that position from April 1999 to July 2003. He is a director of TransAlta Corporation, AMEC plc, Canadian Natural Resources Limited, and Shell Pensions Trust Limited.

Richard George—George joined CP’s board in May 2011. He had been CEO of Suncor Energy since 1991. George has had significant experience with the rail industry as a supplier of fuel as well as shipper of petroleum products.

Krystyna Hoeg—A chartered accountant, Hoeg served as president and CEO of Corby Distilleries from 1996 to 2007. She is also currently a director of Imperial Oil, Sun Life Financial and Shoppers Drug Mart.

Tony Ingram—Ingram started his career as a management trainee at Norfolk Southern Railway and eventually became executive vice-president and chief operating officer at CSX Transportation. He joined CP’s board in December 2011.

Richard C. Kelly—As retired chairman and CEO of Xcel Energy, a utility supplier of electric power and natural gas service in eight U.S. states, Kelly was a customer of railway services, notably moving coal for coal-fired generation plants.

John P. Manley—Manley, who joined CP’s board in 2006, is president and chief executive officer of the Canadian Council of Chief Executives, a not-for-profit, non-partisan group. Manley served as deputy prime minister under Jean Chretien, and was also finance, foreign, and industry ministers.

Linda J. Morgan—Morgan is a partner at Nossaman LLP, a transportation infrastructure law firm based in the United States. She previously served as chairman of the U.S. surface transportation board, the primary regulatory rail authority.

Madeleine Paquin—Paquin, who joined CP’s board in 2001, is president and CEO of Logistec Corp., a cargo-handling company. She has transportation supply chain and rail experience because Logistec operates a short-line rail, moving coal from Sydney, N.S.

Michael E.J. Phelps—Phelps is the chairman of Dornoch Capital Inc., a private investment company. From January 1988 to March 2002 he served as president and chief executive officer and subsequently chairman and chief executive officer of Westcoast Energy Inc.

Roger Phillips—Phillips is the retired president and chief executive officer of IPSCO Inc., a steel manufacturing company. He held that position from February 1982 until his retirement in December 2001.

David W. Raisbeck—Raisbeck, who joined CP’s board in 2009, is retired vice-chairman of Cargill Inc., an agricultural, trading and food processing giant. He has experience as a major shipper of agricultural and industrial products by rail.

Hartley T. Richardson—Richardson, who joined the board in 2006, is president and chief executive officer of James Richardson & Sons, a grain handler based in Winnipeg. He is also chairman of the Canadian Council of Chief Executives.

Source: *Toronto Star*, “Meet CP Rail’s New Board,” May 17, 2012, accessed July 23, 2017, https://www.thestar.com/business/2012/05/17/meet\_cp\_rails\_new\_board.html; Bloomberg Markets, accessed July 23, 2017, www.bloomberg.com/research/stocks/people/person.asp?personId=8442115&privcapId=884393; Canadian Pacific, *Notice of Annual and Special Meeting of Shareholders and Management Proxy Circular,*” May 12, 2011, accessed July 23 2017, http://s21.q4cdn.com/736796105/files/doc\_financials/Annual-Report/2011/cp-proxy-2011.pdf.

**Exhibit 3: stock price performance for Canadian National Railway, Canadian Pacific, and a Canadian Stock Market Index (XIU), May 2002 to May 2012**

**(Indexed to May 1, 2002 = 100)**

Note: Stock prices adjusted for dividends. “XIU” is an index fund tracking the performance of the largest 60 firms in the Toronto Stock Exchange (TSX). XIU’s performance has been roughly similar to the entire TSX’s performance in the 10 years ended May 2002.

Source: Yahoo Finance Canada, accessed August 25, 2017, https://ca.finance.yahoo.com/

**Exhibit 4: Pershing Square—The Nominees for Management Change,   
February 6, 2012**

Three independent Canadian business leaders\*

Gary F. Colter (age 66):

* Founder of CRS (corporate restructuring, strategic and management consulting firm); former vice chair of KPMG Canada; director of CIBC, Owens Illinois, Core-Mark; former director of Viterra
* Restructuring / accounting background, relevant board experience

Rebecca MacDonald (age 58):

* Founder and executive chairman of Just Energy Group Inc. (independent marketer of deregulated gas and electricity), previously founded Energy Marketing
* Entrepreneur, owner-manager, shareholder-value orientation

Dr. Anthony R. Melman (age 64):

* Chairman and CEO of Nevele Inc., provider of strategic business and financial services; former managing director of Onex Corporation
* Strategic transformation, financial acumen

Paul Haggis:

* Haggis is chairman of the Alberta Enterprise Corp., an Alberta government-created venture fund whose mandate is to finance early stage technology companies. From 2003 to 2007, he led the Ontario Municipal Employees Retirement System.

Stephen Tobias:

* Tobias has four decades of experience in the railroad industry. From 1998 to 2009, Tobias served as vice-chairman and chief operating officer of Norfolk Southern Corp.
* Proportionate shareholder representation for Pershing Square

Bill Ackman (age 45):

* Founder and CEO of Pershing Square Capital Management, director of J. C. Penney (NYSE: JCP), chairman of the board of Howard Hughes (NYSE: HHC), director of Justice Holdings (LSE: JUSH)
* Largest shareholder, shareholder value orientation, investment management expertise

Paul Hilal (age 45):

* Partner at Pershing Square Capital Management, former chairman of the board and interim chief executive officer of Worldtalk Communications Corporation, former director of Ceridian Corporation
* Pershing Square’s railroad industry expert, largest shareholder, shareholder value orientation, investment management expertise, investment banking/M&A expertise

Note: CEO = chief executive officer; M&A = mergers and acquisitions; \*independent of Canadian Pacific and Pershing Square Capital Management.

Source: “The Nominees for Management Change,” Pershing Square Capital Management, L.P, February 6, 2012, accessed July 23, 2017, http://cprising.com/content/uploads/2014/06/The-Nominees-for-Management-Change.pdf.

**Exhibit 5: Economic Forecast for Canada and the United States—Key Indicators**



Note: GDP = gross domestic product

Source: The Economist: Intelligence Unit, *Country Report Canada* *April 2012*, accessed November 15, 2017, https://store.eiu.com/product/country-report/canada, 9; The Economist: Intelligence Unit, Country Report *United States April 2012*, accessed November 15, 2017, https://store.eiu.com/product/country-report/united-states, 9.

**Exhibit 6: Canadian Pacific Income Statements, 2009–2011 (year ended december 31, in CA$ millions)**



Source: Canadian Pacific, *2011 Annual Report*, 61, accessed July 23, 2017, http://s21.q4cdn.com/736796105/files/doc\_

financials/Annual-Report/2011/cp-ar-2011.pdf.

**Exhibit 7: Canadian Pacific Balance Sheets, 2010–2011 (as at December 31,  
in CA$ Millions)**



Source: Canadian Pacific, *2011 Annual Report*, 62, accessed July 23, 2017, http://s21.q4cdn.com/736796105/files/doc\_

financials/Annual-Report/2011/cp-ar-2011.pdf.

**Exhibit 8: Canadian Pacific Cash Flow Statements, 2009–2011 (Year ended December 31, in CA$ millions)**



Source: Canadian Pacific, *2011 Annual Report*, 63, accessed July 23, 2017, http://s21.q4cdn.com/736796105/files/doc\_

financials/Annual-Report/2011/cp-ar-2011.pdf.

**Exhibit 9: Comparable Firms’ Valuation Analysis, 2011–2013**



Note: E = estimate; EV/EBITDA = enterprise value ÷ earnings before interest, taxes, depreciation, and amortization

Source: Created by the case authors using data from “Morningstar Investment Research Center,“ Morningstar, accessed May 8, 2012, https://corporate.morningstar.com/us/asp/subject.aspx?xmlfile=244.xml.

**Appendix 1: Proxy Battles**

A proxy battle occurs when a shareholder, or group of shareholders, known as dissidents, join forces and requisition a shareholder meeting or prepare to vote at a company-called shareholder meeting. The proxy battle is the efforts by management and the dissident to gather enough shareholder votes and proxies to win the corporate vote. Usually, the proxy battle is a vote to replace members of the board of directors (BOD). The dissidents will attempt to persuade existing shareholders to vote out the company’s board or a portion of the board, and possibly change management so that the company can embark on the dissident suggested strategy. This “attack” may result in resistance from the company’s BOD, sometimes known as entrenchment. The dissatisfied shareholders try to persuade other shareholders to allow their proxy votes to be used to support proposed changes to the company’s board members. The shareholders trying to change the board members may opt for 100 per cent change or a portion thereof. More recently, dissident shareholders have had success changing 50 per cent of the board members to achieve their corporate directional change and have had an easier time convincing proxy advisors to support less than 100 per cent board change, allowing for some continuity with the existing board and new board members. Even with a few new board members after a proxy battle, returning board members are typically more receptive to shareholders’ proposed changes, making it easier to implement them. The company may move in a new direction, as decided by the BOD and recommended by the dissidents that started the proxy battle.

Management and dissidents use solicitation methods to influence shareholder votes for agenda items proposed at the meeting, most importantly BOD members. All shareholders have voting rights based on their share position holding. Registered shareholders are shareholders that hold their shares directly with the company’s transfer agent. The company has access to their name, address, and share position. Non-registered shareholders hold shares though a broker or custodian, and the company does not have direct access to them or their share position. These shareholders would include retail shareholders that purchase shares through their broker and institutional shareholders, including pension funds and mutual funds that are managing stock on behalf of groups of individuals, but the institutional investor fund manager has the voting authority. In many cases, institutional investors defer voting authority for routine meeting agenda items to one of the two proxy advisors in North America, Glass Lewis, or Institutional Shareholder Services. For a proxy battle, the institutional investor will often direct its voting decision but consider the advice of the proxy advisor. Based on share price and buying power, institutional shareholders carry much more sway in the voting outcome than retail shareholders.

To help facilitate voting, management and/or the dissident may hire its own proxy solicitation firm that contacts shareholders, soliciting their vote. The proxy solicitor compiles a list of shareholders and their approximate share positions, and attempts to contact the shareholders to state the case that they represent. The proxy solicitor (or solicitors) will also arrange a conference call or in-person meeting with the proxy advisors to allow their client, management, or the dissident to present a report on their position.

Ultimately, all shareholders submit their votes to the public company’s transfer agent for tabulation. The tabulation results are shared with the company throughout the process, and final results are sent to the corporate secretary, at the proxy cut-off date, as outlined in the proxy circular. Dissidents and their proxy solicitors may scrutinize and challenge the votes after a meeting to confirm that they accept the outcome, or to note that they think the outcome was unclear (i.e., if they think shareholders voted multiple times or if the votes seem irregular). Directors are approved based on the votes received.

Because most retail shareholders are passive investors, gaining retail shareholders’ attention is difficult. Shareholders typically agree to the recommendations mailed to them without examining the proxy circular, but they also have little impact on the outcome due to their small shareholding.

**Appendix 1 (continued)**

Institutional shareholders consider board and management changes very carefully and will also rely on proxy advisors’ opinions. They are active investors/voters, and they can swing outcomes because of their large share positions. Institutional advisors will also consider management recommendations in making their final decisions, which depend on resolving two questions: “Who does management want on the board and why? Is there some reasonable solution or outcome with the vote that the institutional investors can support?”

Management can rely on a universal proxy to present both its recommendation and the activist’s recommendation on the same form. The universal proxy lists all nominees, both management and dissident, for the board of directors on one proxy form. Shareholders have the option to choose from the list those whom they want on the board, up to the maximum of positions available (i.e., 22 nominees for 17 positions). Management’s recommendation is for its proposed BOD, but shareholders have the option to pick and choose which individuals they wanted to comprise the BOD. Without a universal ballot, the shareholder can be presented with a stark choice of the following two options: vote on the dissident’s proxy form, voting “for” or “withhold” against the dissident nominees; or vote on management's proxy, voting “for” or “withhold” against the management nominees.

In Canada, there is no restriction on a dissident including management’s nominees in its proxy. For example, without a universal proxy, a dissent such as Pershing Square could suggest the Canadian Pacific BOD individuals it wanted to keep on the new BOD. In the particular situation at hand, acting pre-emptively, Canadian Pacific adopted a universal proxy that included Pershing Square’s nominees. This move placed the responsibility of deciding on the new board on shareholders.

Source: Created by the case authors.

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 and Pershing Square Capital Management L.P. or any of their employees. [↑](#footnote-ref-1)
2. Patricia L. Olasker, J. Alexander Moore, and Jennifer F. Longhurst, *Shareholder Activism: The CP Proxy Battle and Emerging Trends*, September 10, 2012, accessed July 23, 2017, https://www.dwpv.com/Sites/academy/PDFs/Fall2012/Davies-Academy-September-10-2012.pdf. [↑](#footnote-ref-2)
3. All currency amounts are in Canadian dollars unless otherwise specified. In 2011, the average exchange rate was CA$1 = US$1.011464. In 2012, the average exchange rate was CA$1 = US$1.000230; “Yearly Average Exchange Rates for Currency,” CanadianForex, accessed September 27, 2017, www.canadianforex.ca/forex-tools/historical-rate-tools/yearly-average-rates. [↑](#footnote-ref-3)
4. Stephen D. Simpson, “A Primer on the Railroad Sector,” Investopedia, accessed July 23, 2017, www.investopedia.com/articles/stocks/11/primer-on-railroad-sector.asp?lgl=rira-baseline-vertical. [↑](#footnote-ref-4)
5. CP, “Our History,” Canadian Pacific, accessed July 23, 2017, www.cpr.ca/en/about-cp/our-history; Canadian Pacific, *Annual Report 2011*, 3, accessed July 23, 2017, http://s21.q4cdn.com/736796105/files/doc\_financials/Annual-Report/2011/cp-ar-2011.pdf. [↑](#footnote-ref-5)
6. Canadian Pacific, “2010 Investor Book,” accessed July 23, 2017, http://s21.q4cdn.com/736796105/files/doc\_downloads/

   resources/cp-2010-investor-book.pdf. [↑](#footnote-ref-6)
7. Ian Austen, “Ackman Wins Proxy Fight at Canadian Pacific,” *New York Times*, May 17, 2012, accessed July 23, 2017, https://dealbook.nytimes.com/2012/05/17/canadian-pacific-c-e-o-and-five-directors-step-down/?mcubz=1. [↑](#footnote-ref-7)
8. U.S. Securities and Exchange Commission, “Form 40-F: Canadian Pacific Railway Limited,” 4, accessed July 23, 2017, https://www.sec.gov/Archives/edgar/data/16875/000119312512116784/d298817d40f.htm; accessed July 23, 2017. [↑](#footnote-ref-8)
9. Ibid. [↑](#footnote-ref-9)
10. Ibid., 6. [↑](#footnote-ref-10)
11. Rich Kirchen, “Target Wins Proxy Fight with Ackman, Pershing Square,” *Business Journal of Milwaukee*, May 28, 2009, accessed July 23, 2017, https://www.bizjournals.com/twincities/stories/2009/05/25/daily23.html. [↑](#footnote-ref-11)
12. See, for example, Lynn Stout, *The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations and the Public*. San Francisco, CA: Berrett-Koehler Publishers, Inc., 2012. [↑](#footnote-ref-12)
13. Government of Canada, Minister of Justice, *Canada Business Corporations Act*,accessed August 28, 2017, http://laws-lois.justice.gc.ca/PDF/C-44.pdf, page 88, item 122 (1)(a). [↑](#footnote-ref-13)
14. “Timeline of CP Rail’s Proxy Battle,” *Toronto Star*, May 17, 2012, accessed July 23, 2017, https://www.thestar.com/business/2012/05/17/timeline\_of\_cp\_rails\_proxy\_battle.html. [↑](#footnote-ref-14)
15. “Canadian Bond Yield: 1-Year Lookup,” Bank of Canada, accessed July 23, 2017, www.bankofcanada.ca/rates/interest-rates/lookup-bond-yields/. [↑](#footnote-ref-15)
16. “The Nominees for Management Change,” Pershing Square Capital Management L.P., February 6, 2012, accessed July 23, 2017, http://cprising.com/content/uploads/2014/06/The-Nominees-for-Management-Change.pdf. [↑](#footnote-ref-16)
17. Scott Deveau, “CP Chief Fred Green Defends His Track Record,” *Financial Post,* March 27, 2012, accessed July 23, 2017, http://business.financialpost.com/investing/cp-chief-fred-green-defends-his-track-record. [↑](#footnote-ref-17)
18. Jacquie McNish, Brent Jang, and Sean Silcoff, “The Story behind the All-Out War to Control CP,” *Globe and Mail*, January 14, 2012, accessed July 23, 2017, https://www.theglobeandmail.com/globe-investor/the-story-behind-the-all-out-war-to-control-cp/article1358769/?page=all. [↑](#footnote-ref-18)
19. Vanessa Lu, “CP Rail Proxy Vote Fight Revived as Pershing Square Adds 7th Nominee,” *Toronto Star*, April 2, 2012, accessed July 23, 2017, https://www.thestar.com/business/2012/04/02/cp\_rail\_proxy\_vote\_fight\_revived\_as\_pershing\_square\_

    adds\_7th\_nominee.html. [↑](#footnote-ref-19)
20. “Battle for Control of CP Rail underway in Calgary Thursday,” CTV News, May 17, 2012, accessed July 23, 2017, www.ctvnews.ca/battle-for-control-of-cp-rail-underway-in-calgary-thursday-1.828862. [↑](#footnote-ref-20)
21. Scott Deveau, “CP Chief Fred Green Defends His Track Record,” *Financial Post*, March 27, 2012, accessed July 23, 2017, http://business.financialpost.com/investing/cp-chief-fred-green-defends-his-track-record/wcm/4aceeeeb-ec83-4060-9a89-118c43f7608d. [↑](#footnote-ref-21)