



## 2011 PROXY SEASON PREVIEW

**2011 promises to be a very interesting proxy season with greater expectations in terms of shareholder engagement and higher shareholder expectations with respect to disclosure from the issuer community.**

On November 18, 2010, Institutional Shareholder Services (“ISS” formerly RiskMetrics Group) released policy updates for all global markets. These updated policy guidelines will be applicable to all companies with shareholder meetings commencing February 1, 2011. Furthermore, in addition to the updated ISS guidelines, issuers must deal with the corporate governance advisory firms (such as Canadian Coalition for Good Governance) that will continue to monitor and push for better corporate governance and transparency at the issuer level. On December 2, 2010 the Canadian Securities Administrators (“CSA”) published the results of its corporate governance compliance review. The positive news is that the review did not result in any issuers having to restate their corporate governance disclosures (in 2007 there were two such incidents); however, the percentage of issuers required to make prospective enhancements to their disclosures increased from 36% to 55%.

What does this mean for issuers and shareholders for 2011? We intend to give a quick overview of the landscape for 2011 and will then set out our thoughts on what to expect and how to avoid common pitfalls. For 2011, we will continue to see the push for Say on Pay; however, we, at Phoenix Advisory Partners (“Phoenix”), believe that there will be an even bigger push now and in the future for issues such as environmental social governance (“ESG”), succession planning, board diversity and a consistent view of the legitimacy of shareholder rights plans (“SRPs”).

### Overview

On November 19, 2010, ISS issued their Canadian Corporate Governance Policy updated guidelines for 2011. The five main topics that will affect Canadian issuers are as follows:

- 1. Board Independence/Board Committee Structure:** The current structure was to generally vote WITHHOLD from any insider or affiliated outside director (and the whole slate if the slate includes such individual directors) of an S&P/TSX company where: (a) the board is less than majority independent; or (b) the board lacks a separate compensation or nominating committee. However, the 2011 policy guidelines now state that this rule will be applicable to ALL TSX companies.
- 2. Equity Compensation Plans:** There currently is no written policy that addresses this specific need. However, for 2011 the change is to codify current practice into policy to supplement the Cost of Equity Plans policy where the compensation model cannot be run or applied due to a lack of historic data for plans introduced as part of the Income Trust Conversions or other M&A transactions.

ISS will vote on a case-by case basis on equity based compensation plans. ISS will vote AGAINST the plan if any of the following factors apply:

- **Cost of Equity Plans:** the total cost of the company's equity plan is unreasonable (e.g. Dilution and Burn rate are unreasonable, where the cost of the plan cannot be calculated due to lack of historical data).
  - **Plan Amendment Provisions:** the provisions do not meet ISS guidelines.
  - **Non-Employee Director Participation:** Participation of directors is discretionary or unreasonable.
  - **Pay for Performance:** There is a disconnect between CEO Pay and the company's performance.
  - **Repricing Stock Options:** The plan expressly permits the repricing of stock options without shareholder approval.
  - **Problematic Pay Practices:** The plan is a vehicle for problematic pay practices.
- 3. Articles of Incorporation/By-Laws:** Current practice is to generally vote FOR proposals to amend or replace if: (a) the purpose of the amendment is to clarify ambiguity, reflect changes in corporate law, streamline years of amendments, or other "housekeeping" amendments; and (b) the by-laws as amended will not result in any corporate governance violations. For 2011 the key changes are to really clarify that an AGAINST recommendation may also result if the proposed articles/by-laws raise other corporate governance concerns such as granting blanket discretionary authority to the board related to capital authorization or alteration of capital structure without shareholder approval.
- 4. Shareholder Rights Plans<sup>1</sup>:** Current practice is to vote on a case-by-case basis on management proposals to ratify a shareholder rights plan (aka "poison pill") taking into account whether it conforms with "new generation" rights plans and its scope is limited to the following two specific purposes: (a) to give the board more time to find an alternative value enhancing transaction; and (b) to ensure the equal treatment of all shareholders. The 2011 changes more or less state that an AGAINST vote will be recommended if the SRP goes beyond the two above-mentioned purposes. ISS will also recommend against any plans that make a reference to derivatives contracts within the definition of beneficial ownership and shareholder endorsed insider bid provisions.
- 5. TSX Venture Guidelines:** The current practice is to generally vote WITHHOLD from individual directors (and the whole slate if the slate includes such individual directors) who: (a) are insiders on the audit committee; (b) are insiders on the compensation committee and the committee is not majority independent; or (c) are insiders (and the whole slate if the slate includes such individual directors) and the entire board fulfills the role of compensation committee and the board is not majority independent. The 2011 guidelines just extend the existing practice to include the nominating committee.

### Other Corporate Governance Issues to be Aware of during the 2011 Proxy Season

Building on the themes that we have witnessed over the last two proxy seasons, we believe that issuers will continue to face pressure from shareholders, the media, CCGG, other third party corporate governance advisory firms and activist funds to have a Say on Pay advisory vote on their ballots for 2011. CCGG has focused, for the most part, over the last couple of years on the "large cap" companies to adopt this advisory vote, but it is clear that the mandate for CCGG will be broader and that Say on Pay is here to stay and we should see a focus over the next year or so onto the "mid caps" and "small caps" in years to come. With respect to issuers that have adopted Say on Pay, Shareholder Association for Research & Education ("SHARE") has stated that there have been 45 issuers that have adopted Say on Pay advisory votes. Furthermore, ISS has stated that they have confirmation that a further thirteen issuers will have an advisory vote on executive compensation in 2011.

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<sup>1</sup> A more detailed discussion of SRPs will follow to discuss the "new" regime regarding the applicability and duration of SRPs

Majority voting is another area that has gained a great deal of support from the advocates of good corporate governance. Based on statistical information received from ISS the number of Canadian issuers that have adopted majority-voting policies in 2008 were 19 issuers; in 2009 it increased to 45 issuers. According to CCGG, as at December 31, 2010 there are currently 145 issuers and/or trust companies that have adopted majority-voting policies governing director elections.

However, we at Phoenix believe that there is another hot corporate governance topic that has been picking up momentum but looks to be front and centre this year -- ESG. In 2010 there were eight such environmental proposals given to issuers. Six of the eight were withdrawn and the remaining went to vote. That number may seem small but based on conversations with CCGG, ISS and SHARE there will be an increase in proposals in 2011 and onwards. The management of ESG risks at TSX listed companies is on the radar screen of a growing number of investors. It has come to our attention that certain funds have already commenced dialogue with companies on ESG risks and have, or are considering, filing shareholder proposals.

It seems that CCGG, which includes 43 institutional investors with over \$1.4 trillion in assets, may be seeing ESG risks in a new light. The CCGG has broadened its definition of "governance" to include, among other things, the board's oversight of an issuer's ESG risks. Investors are increasingly honing in on ESG and are requiring more disclosure to assess whether companies are identifying and managing these risks. In October 2010 the CSA issued CSA Staff Notice 51-333 Environmental Reporting Guidance making it very clear that generic, boilerplate disclosure of environmental risks is not acceptable. While the guidance does not create any new legal disclosure requirements, the guidance clarifies how existing disclosure requirements, such as National Instrument 51-102 Continuous Disclosure Obligations, require companies to assess whether directors are appropriately focusing on risk management, including environmental risk.

## Shareholder Rights Plans

Shareholder Rights Plans (SRP's) have become a lightning rod as of late due to the recent decisions in the Canadian marketplace which has created an apparent inconsistency in the role that the SRP will play in attempting to thwart hostile take-over bids. Over the last few years there have been some regulatory decisions on these very SRPs, which gave a consistent view in Canada between the Alberta Securities Commission ("ASC") with their decision in Re Pulse Data ("Pulse") and the Ontario Securities Commission ("OSC") in their decision of Re Neo Material Technologies ("Neo"). However, in 2010 the British Columbia Securities Commission's ("BCSC") decision regarding Lions Gate Entertainment has now brought to question how the Canadian regulatory bodies and basic Canadian law will view future SRPs.

The topic of SRPs is far too extensive for this 2011 preview but from a general viewpoint the two earlier decisions of Pulse and Neo seemed to give comfort that if:

- a SRP is adopted by the board in the context of, and in response to the unsolicited bid that there is evidence that a process has been undertaken by the board of the target company ("Target") to evaluate and respond to the unsolicited bid that would be determined to be in the best interest of the company and its shareholders as a whole;
- that an overwhelming majority of shareholders that approved the SRP while the unsolicited bid was outstanding;
- there is evidence to support that the Target's shareholders were sufficiently informed about the SRP before casting their votes; and
- there is no evidence to suggest that the Target's management or board coerced or unduly pressured the shareholders to approve the SRP.<sup>2</sup>

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<sup>2</sup> "Rights Plans", Wildeboer Dellelce LLP, October 2010

That neither the OSC nor ASC would decide to cease trade the SRP and in essence would most likely kill any attempt of an unsolicited bid. However, the BCSC decision in Lions Gate Entertainment has brought inconsistency to what has been established over the last few years and leaves one to question where would the provincial securities regulators fall when the next situation presents itself. In the Lions Gate Entertainment case, the BCSC stated (in the Majority reasons) that:

- the principles that shareholders must always have the opportunity to decide cannot exist with one that would allow target boards a “just say no defence”;
- the only reason a securities regulator will tolerate a SRP is to give the target company’s board time to discharge its fiduciary duty – the focus of that duty is to improve the existing bid or to find a better one;
- finally SRPs are acceptable only as a temporary defence. The issue is not whether a SRP should go, but when.

However, the Minority reasons have given some credibility to the ASC and OSC by stating:

that there have been positive developments in corporate governance and board accountability to shareholders that are “supportive of [securities regulators] taking a broader interpretation, and showing greater deference to the business judgement of target boards”. As such, the Pulse and Neo decisions suggest that the analysis of a SRP should not necessarily end once it has been determined that a target’s board is not actively pursuing alternative transactions: other facts may exist that require further considerations before determining whether it is in the public interest to cease trade a SRP.

Therefore, we take the view that when a Target company is faced with an unsolicited bid and adopts a SRP aimed specifically at a particular bid, provides its shareholders with full information regarding the SRP and its effects on the bid, and receives “overwhelming” support from its shareholders in the face of the bid, it may be appropriate to conclude that the continuance of the SRP is in the public interest notwithstanding the fact there may not be any alternative offers forthcoming.

This view and approach only highlights the fact that aligning yourself with a competent, reputable proxy solicitor will allow you to provide the required evidence in light of an unsolicited bid. Management or the board cannot be seen to be placing pressure on shareholders to approve an SRP, therefore, it is prudent to solicit the services of a reliable, experienced proxy solicitation firm to take this responsibility from the Target, and allow the Target to focus on creating shareholder value.

## Recent Developments

On September 22, 2010, Nunavut Iron Ore Acquisition Inc. (“Nunavut”) launched an unsolicited all-cash take-over bid for Baffinland Iron Mines Corporation (“Baffinland”) at a price of C\$0.80 per share. On November 8, 2010, Baffinland entered into a support agreement (the “Agreement”) with white knight ArcelorMittal S.A. (“ArcelorMittal”), the world’s largest steel producer, whereby ArcelorMittal agreed to make an all cash offer to acquire Baffinland at a price of C\$1.10 per share and C\$0.10 per warrant. Under the terms of the Agreement, Baffinland agreed not to waive its SRP until the expiry of ArcelorMittal’s bid. Nunavut made an application to the OSC to cease-trade the Baffinland rights plan and, at a hearing on November 18, argued that it was prevented from taking up any Baffinland shares under its offer until the SRP was terminated. Baffinland and ArcelorMittal sought to have the SRP upheld. On November 19, the OSC issued an order cease-trading the Baffinland SRP. The reasons for the OSC decision for the November 19, 2010 hearing were released on December 3, 2010. In the decision, the OSC had an opportunity to clarify its position on the use of SRPs to block unsolicited take-over bids. In confirming its view from the Neo case, the OSC stated that shareholder approval of a SRP in the face of an unsolicited offer is a significant factor in determining whether to uphold a plan in the absence of an auction. Unfortunately, this decision does not resolve the differing approaches of the OSC and BCSC where shareholder approval of a SRP in the face of a specific bid has been obtained or is imminent and an auction is not ongoing. The inconsistencies between the Lions Gate and Neo decisions arguably suggest that the outcome of a cease-trade hearing on a SRP in these circumstances may vary depending on the jurisdiction in which the application is brought.

## Conclusions

2011 will be a year of continued change and the best way to navigate through these and other landmines is to retain the services of a competent, reputable proxy solicitor. The professionals at Phoenix are not only experienced with annual general meetings but very knowledgeable in the nuances of the plumbing behind the votes and the voting system as well as negotiating and communicating with ISS, CCGG and “activist” funds. The professionals at Phoenix have over 100 years of collective experience and not only wish to provide you with solid exceptional service but creative outside of the box solutions.

With respect to unsolicited bids, issuers do not have a crystal ball and cannot know when an unsolicited bid will arrive at their doorsteps. However, an issuer can take steps to be prepared and aware of shareholder sentiment in order to be in a position to act quickly when a situation presents itself. Phoenix Advisory Partners can assist you by allowing your board to know the general thoughts and temperature of your shareholder base year round. Our professionals are very cognizant of the current corporate governance issues and hot buttons and can assist management and the board to navigate through the quagmire of requirements and policies to stay out of the crosshairs of ISS, CCGG and potential shareholder activists on a year round basis.

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