

PROXY SEASON PREVIEW



Looking Back

To find out where you're going it's a good idea to look from where you've come. In looking ahead to the 2008 proxy season, let's look back at what transpired in 2007.

Votes on equity based compensation plans made 2007 a notable year. This, of course, was in response to the TSX regulatory change, effective June 30, 2007, that now requires issuers to bring any amendments to equity based compensation plans to a vote. The exception to this is if companies specifically obtain shareholder approval for the detailed types of amendments permissible without shareholder approval.

The proxy season saw numerous companies putting forward their stock option plan amendment provisions. Proposals that ran into the most difficulty were generally those that went against institutional investors and ISS Canada (now part of the RiskMetric Group) recommendations on equity-based compensation. These policies and recommendations are biased against plan amendments that allow equity awards to be transferable and those that allow a change in eligible plan participants. Overall, ISS Canada recommended against nearly a third of all equity compensation plan proposals in 2007 – by far the biggest

area of opposition to management in 2007. In Canada, unlike the U.S., companies are not required to report detailed voting results so it's difficult to assess actual voter behaviour. However, in a mini-study undertaken by Kingsdale, 37 companies on the S&P/TSX 60 reported detailed proxy voting results in 2007. Of these, nearly a third, or 30%, received greater than 10% opposition to equity plan or equity plan amendment proposals. Opposition was much higher at non-Index companies where governance standards are usually less strong.

Shareholder Proposals in 2007

It is always interesting to see the success or failure of shareholder proposals, if only because they are typically brought forward by the most passionate owners. As usual, the vast majority of proposals related to issues of corporate governance. The largest number of proposals, by a wide margin (39% of all resolutions that went to vote) addressed concerns over executive compensation. The level of concern over excessive compensation will not take anyone by surprise. Debra Sisti, Director of Research at ISS Canada puts the preoccupation with compensation into context. "As an industry, we have been concerned

ISS POLICY UPDATES

• Audit Committee – All Canadian Issuers

ISS Canada has generally recommended withholding votes from a company's external auditor if fees paid to that firm for "Other" or non-audit related services exceeded fees paid to that firm for all audit related services. In its 2008 policy update, ISS will now also generally recommend against audit committee members (as constituted in the most recently completed fiscal year) who were responsible for selecting and paying those auditors. In the case of slate ballots, a withhold recommendation will apply to the entire slate.

• Limit on non-employee director compensation – TSX Issuers

ISS has historically opposed any discretionary participation of non-employee directors in equity compensation plans. As Debra Sisti, Director of Research, ISS Canada says: "if they're minding the stores, then they shouldn't be able to help themselves to the goods on an unlimited basis." In tightening its upper limit, ISS has now established guidelines of a maximum non-employee

with executive compensation since the late 80s and when I look at some of the documents that were produced in the corporate governance field at this time, and I look at what's coming out now...it's almost the same thing, except the amounts involved are much higher. So we really haven't adequately addressed the issue."

With the growing socially responsible investment industry, and the growing concern among institutional investors over environmental and social issues, it is perhaps surprising that only one climate change resolution was brought before shareholders in 2007. That proposal, at Ultra Petroleum, required the board of directors to "assess how the company is responding to rising regulatory, competitive, and public pressure to significantly reduce carbon dioxide and other greenhouse gas emissions and report [this] to shareholders." For a company only producing natural gas, shareholders gave a notable 17% support for the proposal.

Three notable shareholder resolutions deserve mention because each of them came close to being passed by a majority of shareholders. They all have to do with

executive compensation. A proposal at Nortel, which received 38.5% of the vote, sought to establish a pay-for-superior-performance standard for senior executives.

Shareholder resolutions at Finning International and Manulife Financial requested the board of directors remove variable incentive pay from the companies' supplemental executive retirement plans. The proposals won 41.8% and 43% of the vote respectively.

Looking Ahead - 2008 Proxy Season

The character of every proxy season is informed by a number of related factors, including the changing governance practices of issuers, rule changes, and policy updates by institutional investors and shareholder advisory services.

Majority Voting/Individual Director Elections

There is no denying that corporate Canada has responded to calls to hand more power over to their shareholders. As ISS Canada observes, almost one quarter of S&P/TSX Composite Index companies had adopted a modified majority voting policy (director resignation policy) as of June 2007. These policies require that directors who receive less than a majority of "for" votes must tender their resignation. We are sure to see many more majority voting policies adopted heading into 2008. Bill Mackenzie, Director of Special

director participation limit of the lesser of: (i) a reserve of 1% of the shares outstanding; and (ii) an annual equity award value of \$100,000 per director. Sisti says that backtesting shows that ISS would have "concern" with approximately 15-25% of TSX listed companies. Issuers who feel the need to cross the new \$100,000 threshold must demonstrate compelling rationale and best practices for compensating directors.

• Approval of Change in Control Provisions – TSX Issuers

With the TSX rule changes noted in the first section of this newsletter, Canadian shareholders are now entitled to vote on equity based compensation plan amendments where a detailed plan amendment provision was not adopted by June 30, 2007. Responding to this change, ISS Canada has honed in on change in control (CIC) provisions. ISS Canada will generally recommend against a proposal to add or amend a CIC provision under an equity-based compensation plan if the acceleration and/or cash-out of unvested awards is only triggered by a single event. In other words, it is not enough that there is a change in control but an executive must lose his or her job or have their employment adversely affected by a change in control. This, Sisti calls, the "double trigger. As Sisti says, our clients "generally don't want to see insiders benefiting to a greater extent than shareholders do in change in control transactions."



Projects at the Canadian Coalition for Good Governance (CCGG) and former president of ISS Canada, says that his organization is making a real push on the issue .

Catherine Jackson, Manager, Corporate Governance & Proxy Voting at the Ontario Teachers' pension plan sees the adoption of director resignation policies as a measure of success for institutional investors who have used the patient approach of corporate engagement.

Compared to the U.S., institutional investors here are less inclined to use shareholder proposals to bring about change. In the U.S., there were approximately 40 proposals submitted to issuers in 2007, asking them to institute a majority vote threshold in uncontested director elections. These proposals received an average 50% percent support. Jackson notes that institutional investors, acting in partnership through the CCGG, have compounded their influence.

Looking into the future, Jackson sees current trends continuing: "If I were to give directors any advice, it would be that majority voting is going to take off and shareholders will not hesitate to vote accordingly should the situation warrant it." In other words, corporate Canada is entering a new era of accountability.

Boards are also being engaged on the issue of individual director elections. Today, just under half of S&P/TSX Composite Index companies do not allow shareholders to vote on individual directors. Instead, they put forward nominees as part of a single slate. A shareholder can vote

for them all or withhold from them all.

While there are few investors who defend this system, it particularly riles Jason Milne, Corporate Governance Analyst at Phillips, Hager & North. "It's the one black eye for Canada with respect to board practices... it's a no brainer, it's better governance and it makes boards more accountable." Overall though, most investors, even PH&N, will continue to dialogue and continue to watch as companies slowly and steadily trade slate elections for individual election systems. Certainly, there is no evidence that companies will be facing this issue in 2008 in the form of shareholder proposals.



Say on Pay

In the U.S., there is a lot of talk about giving shareholders an advisory role in executive compensation. In fact, some U.S. companies have committed to "say on pay" and a number of shareholder resolutions on the subject have received majority support. In Canada, despite obvious concern over excessive executive compensation, there does not seem to be a clarion cry for "say on pay".

Indeed, Bill Mackenzie says that the CCGG

has yet to determine a formal policy on the issue. Mackenzie says that while there are other options, "there is no doubt that an advisory vote is a helpful tool for shareholders who want to push back certain controversial pay practices." Mackenzie relates a conversation he had with an experienced director who chairs two compensation committees looking into "say on pay"; the director, Mackenzie says, "described Canadian institutional investors generally, as uninterested in having a detailed discussion on executive compensation." Many boards would agree and believe that compensation is too complex an issue for most shareholders. That being said, Mackenzie predicts that we will see "say on pay" proposals at some of Canada's largest issuers in the 2008 proxy season.

Climate Change

On the social and environmental front, one might expect the growing international concern over climate change to translate into shareholder proposals. In 2007, a number of proposals were put forward but ultimately withdrawn after commitments were made by target companies to incorporate climate change risk into strategic planning, or at least, to report on greenhouse gas management systems and emissions levels.

Ethical Funds, Canada's largest socially responsible fund family is engaging with numerous issuers on this issue. A lot of their effort is focused on encouraging companies to report to the Carbon Disclosure Project, an international coordinating secretariat for institutional investors seeking greenhouse gas emissions data from the world's largest companies.

The organization represents investors with a combined \$US 41 trillion of assets under management. Jason Milne of PH&N speculates that the success of engagement strategies, and the uncertainty over future regulation, has probably limited the number of shareholder proposals on climate change. Nonetheless, he says he "wouldn't be surprised to see some of these proposals on the ballots in 2008."

In Conclusion

When it comes to opposition to management resolutions, it's expected that 2008 will resemble the 2007 season. The recent TSX rule change that gives shareholders more say over equity based compensation arrangements will continue to play out. Specifically, companies will continue to face a steady degree of opposition to their amendment provisions, especially those that allow for transferable equity awards and those that allow for a change in eligible plan participants.

Most analysts expect a quiet proxy season as Canadian investors seem, by and large, content to push for governance changes through measured dialogue. Corporate leaders must surely get some credit for their willingness to listen; but they should not become complacent. As Catherine Jackson says, "We're willing to be patient ...but we will not support decisions that serve to enrich management on the backs of shareholders."

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