DAVIES INSIGHTS

2014

GOVERNANCE

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Governance Insights

2014

Davies Ward Phillips & Vineberg LLP is an integrated firm of approximately 240 lawyers with offices in Toronto, Montréal and New York. The firm is focused on business law and is consistently at the heart of the largest and most complex commercial and financial matters on behalf of its clients, regardless of borders.

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Executive Summary

This fourth annual edition of ***Governance Insights*** presents Davies' analysis of the important trends and developments in corporate governance for Canadian public companies during 2014. In addition to providing guidance to boards and senior management of public companies and their investors on emerging or recurring governance themes, the report contains our internally gathered empirical data and analysis on the prevalence of various governance practices among Canadian issuers listed on the Toronto Stock Exchange.

Corporate governance issues continue to be under focus by Canadian issuers and other market participants, with 2014 revealing many trends similar to those in 2013. We expect that the 2015 proxy season will be another active year for governance themes, with continued calls for leadership diversity among public companies, a growing shareholder voice on "say on pay" resolutions, further regulatory initiatives regarding proxy voting reform and the regulation of proxy advisory firms, and ongoing shareholder engagement and activism. We also anticipate the publication and implementation of amendments to Canada's take-over bid rules and the early warning reporting regime, consistent with the proposals announced in September 2014 and October 2014, respectively.

We begin our report by reviewing current topics of interest relating to the composition of Canadian boards in Chapter 1, Directors and Boards. Our analysis of the gender profile of boards reveals a modest increase in female representation, as well as a positive trend in the overall leadership by women on boards. Notwithstanding these trends, we note that gender disparity persists and the rate of change continues to be relatively slow. We review the recent regulatory developments aimed at addressing these issues to help prepare issuers and their boards to respond to the enhanced disclosure requirements adopted by Canadian securities regulators relating to the representation of women on boards and in executive officer positions. We also discuss the usage of term limits and retirement policies by issuers within the larger debate concerning board tenure and renewal.

In Chapter 2, we review the Executive and Director Compensation practices of Canadian issuers and comment on the trends that we have observed over the last three years. Important trends include the continued increase of say on pay shareholder votes on executive compensation as a tool for fostering shareholder engagement. The upward trend is not only evident among larger Canadian issuers, which have been putting forward such votes for the past few years, but also gaining momentum among the remaining issuers on the TSX Composite and SmallCap indices. We expect this trend to continue into 2015 and beyond, due to both the continued support for the practice and greater scrutiny over the pay-for-performance alignment of Canadian issuers. We also review how Canadian issuers are typically compensating their directors and senior executives.

In Chapter 3, **Shareholder Voting Issues**, we provide an update on the status of Canadian regulators' initiatives on proxy voting reform and the regulation of proxy advisory firms — two areas in which we expect to see further developments in 2015. As with last year, 2014 witnessed a continued focus by Canadian securities regulators on the issues and challenges relating to the operation of the proxy voting system that Davies initially canvassed in our 2010 paper *The Quality of the Shareholder Vote in Canada*. We also review the status and evolution year over year of public companies' practices in the area of majority voting — a practice now required of TSX and other non-venture issuers in Canada. Although the practice is now firmly entrenched, there remains scope for further developments in this area due to continued concerns about the "exceptional circumstances" relied on under majority voting policies to allow directors who fail to achieve majority approval to remain on an issuer's board.

In Chapter 4, **Hot Topics in Proxy Contests and Shareholder Activism**, we review the number of Canadian proxy contests in 2014 to date and note that this year has not witnessed the anticipated level of growth in proxy contests for reasons discussed in greater detail in the chapter. We also discuss some of the significant proxy contests that emerged in 2014. We note that management and incumbent directors appear to have fared better than in prior years. We consider some recent developments concerning director nominee compensation arrangements used by activists, as well as defence mechanisms such as advance notice requirements, enhanced quorum by-laws and "voting pills" being used by issuers in varying degrees as a shield against activism. We also provide an update on the Canadian regulators' recent announcement to keep the early warning reporting threshold at 10%, and canvass recent judicial developments relating to the solicitation of proxies.

Canadian boards have long considered the shareholder rights plan as a potentially effective tool for responding to significant stock accumulations and unsolicited bids. In recent years, companies have been facing uncertainty as to when and if "a rights plan must go" as a result of some rights plan decisions by securities regulators and two alternative regulatory proposals put forward in 2013. Against this background, in Chapter 5, **Rights Plans and Take-Over Reform**, we discuss the recent unanimous announcement by Canada's securities regulators not to pursue the two previous proposals on shareholder rights plans and take-over defence tactics, and instead to propose amendments to the take-over bid rules that would mandate a 120-day period for all take-over bids. These amendments, if implemented, would effectively give target boards more time to respond and seek alternatives to a hostile bid and make bids materially more challenging for hostile bidders than they are under current Canadian take-over bid rules.

Executive Summary

A number of trends in risk management have developed over the past couple of years that are important for Canadian boards to consider, with 2014 bringing into focus additional areas of concern. As in 2013, risk management practices and guidelines regarding anti-bribery and corruption of public officials remain very important for Canadian companies operating abroad, particularly in emerging markets. In addition, boards must be increasingly aware of and address issues regarding cyber risks and the protection of data belonging to customers and others with whom they do business. These issues, together with the recent implementation of extensive anti-spam legislation in Canada that includes director liability, are canvassed in Chapter 6, **Trends in Board Risk Management**.

If you would like to discuss any of the issues raised in *Governance Insights 2014* or our previous annual governance reports, please contact any of the Davies partners listed on the Key Contacts page.

Database and Methodology

The data in chapters 1, 2 and 3 of this report are drawn from the 2014 management information circulars of 372 issuers on the Toronto Stock Exchange (TSX), which are included in one (or both) of the Composite Index and the SmallCap Index as at May 31, 2014. There are a total of 2,345 issuers listed on the TSX. Although the 372 Composite Index and SmallCap Index issuers included in our study represent only 16% of all TSX-listed issuers, they represent 84% of the total market cap on the TSX.[1]

Descriptions of the relevant indices discussed in this paper are set out below.

Composite Index: The S&P/TSX Composite Index (referred to as the Composite Index) comprises 244 issuers. It is the "headline index" and the principal broad market measure for the Canadian equity markets. It includes common stock and income trust units. Four of the 244 Composite Index issuers did not issue a proxy circular for the relevant time period discussed; accordingly, our analysis is based on 240 Composite Index companies.

Two components of the Composite Index are referred to in this report:

- **TSX 60:** The S&P/TSX 60 Index (referred to as the TSX 60) is a subset of the Composite Index and represents Canada's 60 largest issuers by market capitalization.
- **Completion Index:** The S&P/TSX Completion Index (referred to as the Completion Index) is the Composite Index excluding the TSX 60 issuers. It comprises 184 issuers. (Our analysis includes only 180 of the issuers on the Completion Index because, as noted above, four issuers did not issue proxy circulars.)

SmallCap Index: The S&P/TSX SmallCap Index (referred to as the SmallCap Index) includes 213 issuers, 72 of which also meet the market capitalization eligibility criteria and are part of the Composite Index.[2] (Our analysis includes only 204 of the issuers on the SmallCap Index because nine issuers did not have circulars.)

Where we reference a corporate statute in this report, we are referring to the *Canada Business Corporations Act* (CBCA), unless otherwise stated.

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1 As at May 31, 2014.

2 To qualify for the Composite Index, an issuer must, at the time of determining eligibility, (a) represent a minimum weight of 0.05% of the index and (b) have a minimum volume-weighted average share price of at least $1.00. To qualify for the SmallCap Index, an issuer must have a market capitalization that is at least $100 million, but not more than $1.5 billion.

01 Directors and Boards

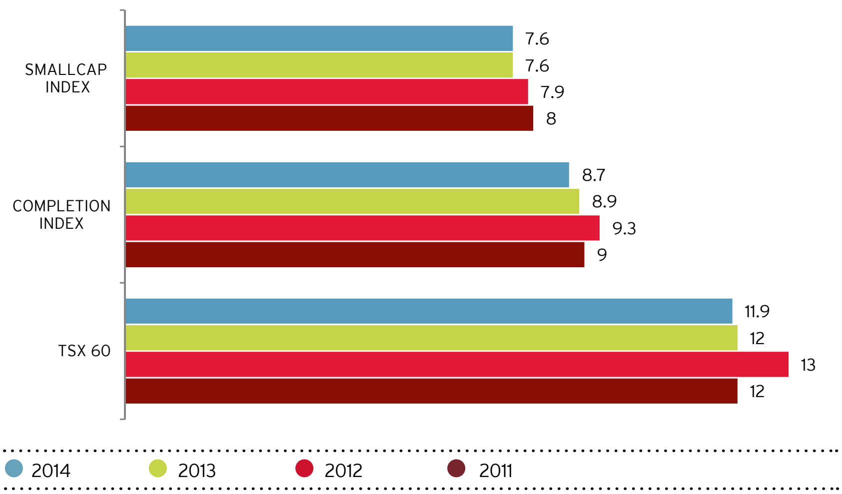
01 Directors and Boards

Director Profile

The *Davies Governance Insights 2013*[3] edition provided a detailed examination of certain aspects of the profile of the typical director of a TSX company, such as age, gender, residency, service on other boards and independence. With the exception of gender profile, which is addressed in detail herein, the attributes of the typical director have remained relatively constant this proxy season.

Board Size

AVERAGE SIZE OF BOARDS (NUMBER OF DIRECTORS)



Board size was a topic discussed in depth in our *Governance Insights 2013* edition. The table above presents the average size of the boards of companies on the TSX 60, Completion Index and SmallCap Index for each year since 2011. While there has been no significant variation year over year in the average size of a board, one development in this area to be noted is the guidance of Glass Lewis & Co. (Glass Lewis) in its *2014 Proxy Voting Guidelines*. Glass Lewis has expressed the view that boards should have a minimum of five directors (or four directors in the case of a company listed on the TSX Venture Exchange (TSXV)) in order to ensure diversity of views and breadth of experience, but that boards

3 http://www.dwpv.com/en/Resources/Publications/2013/Davies-Governance-Insights-2013.

with more than 20 directors will have difficulty reaching consensus and making timely decisions. As a result, Glass Lewis will generally recommend withholding votes from the chair of the nominating and/or governance committee (or the chair of the board in the absence of such committees) of companies with boards consisting of fewer than five directors (or four directors for companies listed on the TSXV). For boards consisting of more than 20 directors, Glass Lewis will generally recommend withholding votes from members of the nominating committee, or governance committee in the absence of a nominating committee.

None of the issuers in our 2014 study had boards exceeding 20 directors (the two largest boards consist of 18 directors and both are boards of issuers on the Composite Index). On the other end of the spectrum, there were two companies with three-member boards (both part of the SmallCap Index) and two issuers with four-director boards (in each case, members of both the Composite Index and the SmallCap Index).

Overcommitted Directors

Influential proxy advisory firms Institutional Shareholder Services (ISS) and Glass Lewis updated their proxy voting guidelines in 2014 to include a number of new considerations to guide their voting recommendations to shareholders in the 2014 proxy season. One of the considerations is the issue of "overboarding" – a concept referring to situations in which a director serves on an excessive number of boards.

Glass Lewis has stated that it will generally issue a withhold recommendation for (a) a director who serves as an executive in addition to serving on more than three public company boards, and (b) a non-executive director who serves on more than six public company boards. Glass Lewis has also stated that it *may* not recommend that shareholders withhold votes from overcommitted directors at the companies where they serve an executive function, given that an executive will presumably devote requisite attention to his or her executive duties. Glass Lewis's guidelines are more lenient with respect to companies listed on the TSXV, for which it will generally permit directors to serve on up to nine boards.

ISS takes a slightly different approach by looking not only at the number of public company boards on which a director serves, but also at the director's attendance record. ISS defines a director as "overboarded" if he or she is (a) a CEO of a public company who sits on more than two outside public company boards in addition to the company of which he or she is the CEO, or (b) not a CEO of a public company and sits on more than six public company boards. ISS will generally recommend withholding votes from a director who both meets the definition of overboarded *and* has attended less than 75% of his or her respective board and committee meetings held within the past year without a valid reason for the absences. No guidance is provided on what may constitute "valid reason" in such cases.

Skills Matrix Disclosure

In its *2013 Best Practices for Proxy Circular Disclosure*,[4] the Canadian Coalition for Good Governance (CCGG) recommends certain governance practices relating to director qualifications, including the disclosure of a director skills matrix. A similar recommendation for the board to prepare a competency matrix was initially included in a 2012 draft Corporate Governance Guideline issued by the Office of the Superintendent of Financial Institutions (OSFI) setting forth OSFI's expectations for corporate governance of federally regulated financial institutions. The specific reference to the competency matrix was, however, ultimately removed from OSFI's Final Guideline, leaving the board more scope to determine how best to conduct this assessment and recommending that the board integrate its assessment into its succession and renewal plans.

Despite the absence of a formal requirement, a number of Canadian issuers include a skills, or competency, matrix in their annual circulars, which outlines each director's expertise level in areas that are deemed to be required, with each director indicating the level to which she believes she possesses such competency. A skills matrix may list areas of competence (for example, telecommunications, technology, accounting and finance, risk management) and other relevant characteristics, such as age, tenure, languages and geographic background, against each director nominee's name.

The practice of disclosing a skills matrix is more prevalent among Canada's largest issuers. In the 2014 proxy season, a competency matrix was included in the management information circulars of 20 issuers (33%) on the TSX 60; 34 of 180 issuers (19%) on the Completion Index; and 16 of 204 issuers (8%) on the SmallCap Index.

A middle approach that some issuers employ is disclosing in their circulars a modified version of a skills matrix – one that sets out the number of directors possessing each specific skill or experience, short of specifying the individual directors with such skill or experience. On the other end of the spectrum, some issuers refer only to the fact that the governance committee of their board maintains and periodically updates a skills matrix to assist in identifying and

4 http://www.ccgg.ca/site/ccgg/assets/pdf/2013_best_practices.pdf.

evaluating potential new board members against existing skills and experience on the board, without disclosing the matrix itself.

The utilization of skills or competency matrices in some form remains more prominent among larger TSX-listed issuers, with increased scrutiny being placed on the relative skills and effectiveness of boards, their committees and individual directors, as well as increased focus on and expectations surrounding improving the diversity of leadership among Canada's public companies (as discussed further below). However, boards should consider whether developing a skills or competency matrix, even if not publicly disclosed, will better assist them in evaluating their relative effectiveness, and take action where there may be perceived or actual gaps in the relative skills and competencies that are needed to best achieve the company's objectives.

Independence of Chairs and Lead Directors

In Canada, as part of its proxy disclosure requirements, National Policy 58-201 *Corporate Governance Guidelines* (NP 58-201) recommends that the chair of a reporting issuer be an independent director. Where this is not appropriate, an independent director should be appointed as lead director. The policy also recommends that either an independent chair or an independent lead director act as the effective leader of the board. NP 58-201 further recommends that the board develop clear position descriptions for the chair of the board and the chair of each board committee. Reporting issuers are required to disclose whether the board has developed such position descriptions and if not, describe how the board delineates the role and responsibilities of each position. There are no specific guidelines relating to position descriptions for lead directors.

Proxy advisory firms, institutional shareholders and corporate governance groups advocate that companies have a chair independent of management as a means of fostering the independence of the entire board. The creation of a lead director position to be occupied by an independent director is generally viewed as an acceptable alternative to a non-independent chair, provided that the lead director is sufficiently empowered to counterbalance the influence of the issuer's non-independent chair.

Recognizing that there is no one-size-fits-all approach to selecting a board leadership structure, some institutional investors recommend that companies, regardless of their structure, justify why their chosen structure is in the best interests of shareholders, considering the company's particular circumstances. In addition, one institutional shareholder, the Caisse de dépôt et placement du Québec, considers that it is incumbent on the board to review and evaluate on a regular basis the appropriateness of its chosen leadership structure and to report thereon to the annual meeting of shareholders, which should be asked to vote on the leadership structure when recommended by the board.

Our review of the 2014 proxy circulars shows that, consistent with 2013, 60% of the chair positions on the Composite and SmallCap indices are held by independent directors. On the TSX 60, there are 23 issuers that have non-independent chairs. Twenty of those companies (87%) have an independent lead director. On the Completion Index, 67 of the 71 companies (94%) with non-independent chairs have independent lead directors. On the SmallCap Index, 57 of the 73 companies (78%) with non-independent chairs have independent lead directors.

Women in Leadership Positions

Over the past several years, pressure to increase gender diversity among Canada's public companies has continued to mount, resulting in some progress during 2013 and 2014 over prior years in the representation of women among the leadership of TSX-listed companies. Gender diversity on Canadian boards received particularly heightened attention in 2014 due to several developments. These included the release by the Ontario Securities Commission (OSC) and certain participating regulators of the Canadian Securities Administrators (CSA) of the final enhanced disclosure rules for public companies designed to promote gender diversity; the appointment of Kathleen Taylor as the first female board leader of a major Canadian bank; and continued calls by the federal government's Women's Minister to further improve the representation of women among Canada's leadership. The main issues receiving scrutiny continue to be the number of women on boards and the rate at which they rise to leadership positions once they are appointed to the board.

While the representation of women on boards is more common among Canada's largest issuers – those that make up the TSX 60 – 2014 also witnessed a greater propensity among Completion Index and SmallCap Index issuers to include women on their boards. The number of TSX 60 issuers that put at least one woman forward for election by shareholders increased from 88% in 2011 to 99.3% in 2014, up from 90% in 2013. Similarly, the percentage of TSX 60 issuers that put two or more female candidates forward rose from 65% in 2011 to 80% in 2014, again an improvement from 72% in 2013. Following along the same trend, the percentage of issuers that did not put forward any women on the Completion Index decreased from 57% in 2011 to 40.6% in 2014, and on the SmallCap Index decreased from 65% in 2011 to 57.8% in 2014.

01
Directors and Boards

PROGRESS OF WOMEN IN LEADERSHIP POSITIONS

Despite some meaningful progress on the overall representation of women on boards, the percentage of women holding leadership positions with TSX-listed companies remains relatively low. As noted above, in 2014, Kathleen Taylor became the first woman to lead the board of a major Canadian bank upon her appointment to the board of Royal Bank of Canada in January 2014. However, the broader trend suggests that the incidence of women holding board leadership positions has remained fairly flat. For example, there continue to be only two female chairs on the TSX 60 (3%) – Maureen Sabia, of Canadian Tire Corporation Limited, and Kathleen Taylor, of Royal Bank of Canada. The percentage of women chairing boards on the Composite Index and the SmallCap Index actually declined to 3.2% in 2014, down from 4% in 2013.

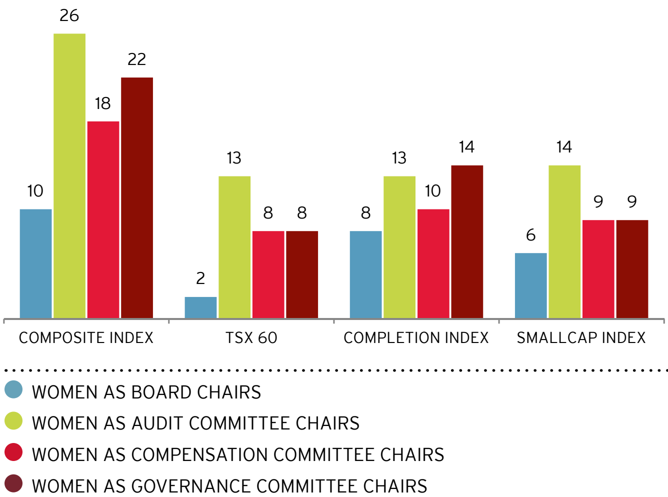
Compared with 11 women chairs of issuers on the Completion and SmallCap indices in 2013, there are 10 women chairing boards of those issuers in 2014: Nancy Southern (ATCO Ltd., Canadian Utilities Ltd.); Phyllis Yaffe (Cineplex Inc.); Heather Shaw (Corus Entertainment Inc.); Vincenza Sera* (Dundee Industrial REIT); Lynn Loewen (Emera Inc.); Rebecca MacDonald (Just Energy Group Inc.); Susan McArthur* (KP Tissue Inc.); Isabelle Courville (Laurentian Bank of Canada); Paula Rogers* (Timmins Gold Corp.); and Isabelle Marcoux (Transcontinental Inc.).[5]

Catalyst Inc., a non-profit organization supporting opportunities for women in business, has been conducting a review of boards every two years since 1998 and has noted a faster rate of growth for women leaders over the past two years. The *2013 Catalyst Census: Financial Post 500 Women Board Directors*[6] indicates that while past surveys have typically shown a rate of growth in female directors on boards of publicly traded companies of about 0.5 percentage points for every two years, its 2013 survey indicates an increase of about 1.5 percentage points from 2011 to 2013, which it views as an encouraging rate of improvement. For example, in 2013, its survey of 266 public companies, 106 private companies, 40 Crown corporations and 10 cooperatives shows that women held 15.9% of board seats, compared with 14.5% in 2011. Similarly, Catalyst reported that in 2013, women's representation at the public companies they surveyed increased nearly two percentage points from 2011 to 2013, although they note that public company boards continue to have the lowest representation of women compared with the boards of private, Crown and cooperative companies; Crown corporation boards had the highest representation of women in both 2011 and 2013.

5 The * denotes new female chairs appointed in 2014.

6 http://www.catalyst.org/system/files/2013_catalyst_census_financial_post_500_women_board_directors.pdf.

WOMEN AS BOARD AND COMMITTEE CHAIRS



At the board committee level, women appear to be gaining greater leadership participation, although their representation on certain committees tends to be more prevalent than on others. In 2011, there were 12 instances among TSX 60 issuers of women chairing the audit committee, the compensation committee or the governance and nominating committees. By 2014, this number had risen to 29, up from 25 in 2013. An increase is also observed on the Completion Index, where the number of female chairs of such committees rose from 28 in 2011 to 37 in 2014 (32 in 2013) and on the SmallCap Index, from 26 in 2011 to 32 in 2014 (28 in 2013). Despite these improvements, the prevalence of women on other board subcommittees, such as risk, environmental, health, and reserves committees is meaningfully smaller.

A positive trend in the overall leadership of women on boards is also evidenced by the fact that in 2014, of the almost 1,200 committees across both the Composite Index and the SmallCap Index (taking into account the fact that some issuers are listed on both indices), 102 committees (8.6% of such committees) were chaired by women, up from just 85 of almost 1,200 (7.1%) in 2013 and only 53 of more than 1,500 committees (3.5%) in 2011.

The *2013 Catalyst Census: Financial Post 500 Women Board Directors* notes that while women's representation in nominating and governance committee chairs continued to keep pace with the growth in overall share of board seats, women's representation in all other board leadership positions continued to lag behind their share of overall board seats. For example, the prevalence of women holding board chairs or lead director positions continues to remain relatively flat in 2013 compared with 2011 (4.1% and 3.6%, respectively, in the case of board chairs, and 4.2% and 3.8%, respectively, in the case of lead directors). Catalyst also revealed that while 2013 saw some meaningful progress, which is further evidenced in 2014 as shown by the results we report on herein, more than one-third of companies surveyed still continue to have no women on their boards, four out of 10 public companies have no women on their boards, and only three public companies in 2011 and five public companies in 2013 had 40% or more women directors.

RECENT DEVELOPMENTS IN LEADERSHIP DIVERSITY

Although female representation on boards and in board leadership positions continues to show positive progress over the past three years, the rate of increase continues to be relatively slow (and for many, too slow). Gender disparity persists. For example, out of the total 3,253 board seats of issuers on the Composite Index and the SmallCap Index, a modest improvement of 401 (12.3%) of board seats were held by women, an increase over 10.5% in 2013. Similarly, the percentage of board positions on the TSX 60 held by women increased from 18.4% in 2013 to 20.1% in 2014; on the SmallCap Index, it is now 7.8% (6.4% in 2013). There has also been a decline in the number of issuers on the Composite and SmallCap indices that do not have any female board members, declining from 40% in 2013 to 32.1% in 2014 and from 65% in 2013 to 57.8% in 2014, respectively.

Enhanced disclosure rules have now been adopted to foster the representation of women on boards and in executive officer positions among Canadian public companies.

The lack of board diversity in Canada has been an increasingly pressing issue over the past few years and continues to attract attention from a variety of constituents, including Canada's federal government, securities regulators, investors, governance watchdogs and other stakeholders.

Following various published reports and public consultations, surveys and roundtables held by the OSC in 2013 soliciting feedback on the most effective policies and disclosure practices for increasing the number of women on boards and in executive positions, on January 16, 2014, the OSC published for comment proposed amendments to the existing governance disclosure requirements of Form 58-101F1 *Corporate Governance Disclosure* (Form 58-101F1), under National Instrument 58-101 *Disclosure of Corporate Governance Practices* (NI 58-101). Comments on the OSC's proposed amendments were due by April 16, 2014, and over 50 responses were received from an array of business groups, law firms, governance advocacy groups and corporate directors. On July 3, 2014, several other participating securities regulatory authorities of the CSA followed the OSC's path and published for comment similar proposed amendments to Form 58-101F1 (collectively, we refer to these as the Draft Disclosure Amendments). Subsequently, on October 15, 2014, the securities regulatory authorities of Manitoba, New Brunswick, Newfoundland and Labrador, Northwest Territories, Nova Scotia, Nunavut, Ontario, Québec and Saskatchewan (participating jurisdictions) announced the final amendments to Form 58-101F1 under NI 58-101 (the Final Disclosure Rule). Provided that all the necessary ministerial approvals are obtained, the Final Disclosure Rule will come into effect on December 31, 2014, in time for the 2015 proxy season. The securities commissions of Alberta, British Columbia and Prince Edward Island have not participated in the Final Disclosure Rule.

As expected, the Final Disclosure Rule implements an enhanced "comply or explain" disclosure model regarding director term limits and other mechanisms of board renewal (also discussed below under "Board Renewal Issues: Term Limits and Retirement Policies") and the representation of women on boards and in executive officer positions. It does not introduce any mandatory quotas or targets (adopted by some foreign jurisdictions). The Final Disclosure Rule requires, among other things, TSX-listed and other non-venture issuers to annually disclose in their proxy circulars or annual information forms the following:

- the number and proportion of women on the board and in executive positions;
- written policies on the representation of women on the board or an explanation for the absence of such policies;
- if such a policy has been adopted, disclosure of its objectives and key provisions, the measures taken to ensure its effective implementation, the annual and cumulative progress made on achieving objectives and whether (and how) the effectiveness of the policy is measured;
- the board's (or committee's) consideration of the level of representation of women in the director identification and nomination process, or an explanation of the absence of such consideration, including whether it considers the level of female representation on boards in identifying and nominating candidates, and if not, why not;
- the consideration given to the level of representation of women in executive positions when making appointments, or an explanation of the absence of such consideration;
- any targets (a number or percentage, or a range of numbers or percentages) voluntarily adopted by the issuer regarding female representation on the

board or in executive positions, and if no targets have been adopted, an explanation for their absence; and

- a description of any director term limits or other mechanisms of board renewal voluntarily adopted by the issuer for the directors on its board or an explanation for their absence if no such limits or mechanisms have been adopted.

The Final Disclosure Rule is intended to promote more effective boards and better corporate decision-making by requiring greater transparency for investors and other stakeholders regarding the representation of women on boards and in senior management. This transparency is in turn intended to assist investors when they make investment and voting decisions.

The Final Disclosure Rule is substantially the same as the Draft Disclosure Amendments initially published for comment by the OSC and the securities regulatory authorities of the other participating jurisdictions earlier in 2014, subject to the following principal modifications:

- The Final Disclosure Rule requires disclosure only of written policies regarding the representation of women on the board; informal or unwritten policies are not required to be disclosed. This change addresses comments received on the Draft Disclosure Amendments that supported a narrower definition of what constitutes a "policy".
- The Final Disclosure Rule clarifies that if issuers have voluntarily adopted targets regarding the representation of women on the board and in executive officer positions, they must disclose not only that they have done so, but also the target adopted. This clarification addresses an expressed concern that the Draft Disclosure Amendments were not sufficiently clear that the actual targets must be disclosed.
- The Final Disclosure Rule requires disclosure of the number and proportion of women in executive officer positions within an issuer and its "major subsidiaries", rather than all of its subsidiaries. Again, this modification addresses some expressed concerns in the comments on the Draft Disclosure Amendments that capturing all subsidiaries, particularly for issuers that have several subsidiaries, would be unduly broad.
- Lastly, the Final Disclosure Rule requires issuers to disclose not only whether or not they have adopted term limits, but also whether they have adopted other mechanisms for board renewal and, if so, to include a description of those limits or other mechanisms. This change takes into account the diversity of means by which boards encourage renewal.

The Final Disclosure Rule reflects the fact that, generally, the comments received on the Draft Disclosure Amendments strongly supported the initiative to increase board diversity, in particular, the representation of women on boards and in senior management of public companies. In general, most commentators preferred the comply-or-explain approach over mandatory quotas or targets.

However, some commentators on the Draft Disclosure Amendments urged the regulators to go further and strengthen the proposed rules to make them less voluntary. Many commentators, including the Institute of Corporate Directors, indicated that the proposed amendments should consider more than just gender, urging the regulators to expand the initiative to include reporting on diversity in areas such as race, ethnicity and Aboriginal status, as well as age, experience and geographic background. Similarly, while many believe that the Final Disclosure Rule will be effective in promoting increased representation of women among the leadership of Canadian public companies, some commentators on the Draft Disclosure Amendments expressed concern that the comply-or-explain model is inadequate because voluntary efforts by Canadian companies have thus far resulted in little or no change to board diversity. For example, in response to the initial OSC Draft Disclosure Amendments, the Public Sector Pension Investment Board, which manages federal employee pension plans, advocated that mandatory targets be established and also suggested that sanctions be imposed on companies if there is no progress on diversity within three years. Similarly, the British Columbia Investment Management Corp., one of Canada's largest investors, not only echoed the call for mandatory targets but also suggested that issuers be required to have written diversity policies, which would otherwise be voluntary under the Final Disclosure Rule.

With the Final Disclosure Rule having just been adopted prior to finalizing this report, it remains to be seen what impact the Final Disclosure Rule will have on Canadian issuers' diversity practices and the quality of their disclosure in the coming proxy season. We expect that some market participants will continue to press for more stringent reforms in this area, consistent with some of the comments briefly summarized above.

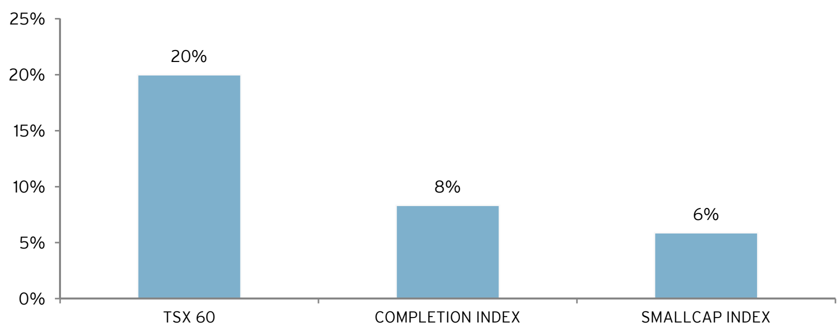
01
Directors and Boards

GENDER DIVERSITY POLICIES AND TARGETS

Although the Final Disclosure Rule will not require issuers to adopt a formal written diversity policy or fixed targets or quotas for the number of women to be appointed to the board or senior management, some leaders have already adopted such policies, and it is expected that issuers will increasingly adopt some form of policy for considering diversity at least at the board level.

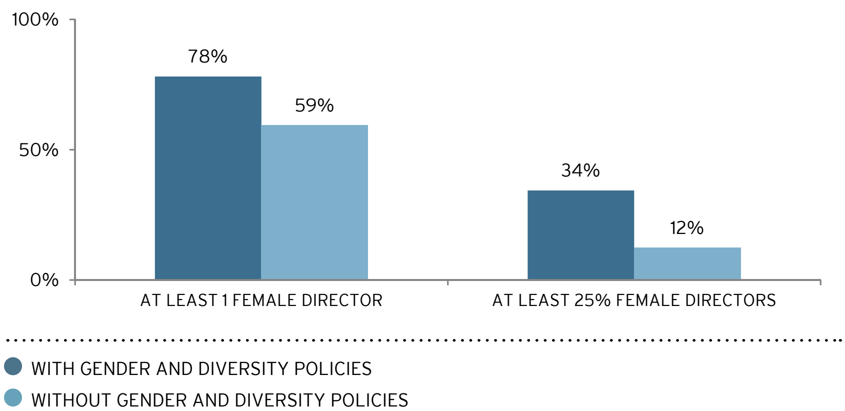
Among all Composite and SmallCap Index issuers, in 2014, 8.6% of issuers (32 of 372 issuers) had a policy or guidelines in place regarding the representation of women on the board or on diversity more generally. Not surprisingly, the incidence of such policies is higher among TSX 60 issuers, of which 20% had such a policy or guidelines; 8.3% of Completion Index issuers and 6% of SmallCap Index issuers had such policies.

PERCENTAGE OF ISSUERS WITH DIVERSITY POLICIES



Gender and diversity policies had a significant positive effect on female directorship on TSX 60, Completion Index and SmallCap Index issuers. Among Composite and SmallCap Index issuers that had gender and diversity policies, 78.1% (25 out of 32 issuers) had at least one female director, compared with 59.4% (190 out of 340) of issuers that did not have gender or diversity policies in place. In a similar trend, 34.4% (11 out of 32) of issuers with gender and diversity policies had females making up at least 25% of the board of directors, compared with 12.4% (42 out of 340) of issuers without such policies.

FEMALE DIRECTORSHIP FOR COMPOSITE AND SMALLCAP ISSUERS WITH AND WITHOUT GENDER AND DIVERSITY POLICIES



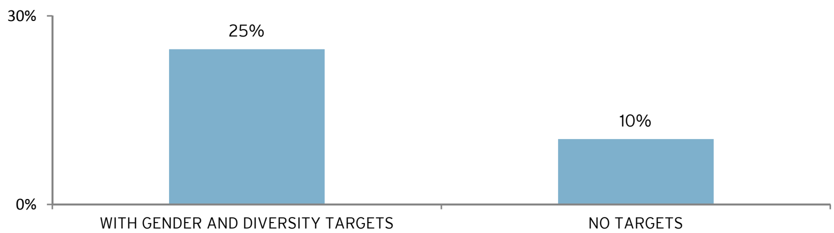
Among TSX 60 issuers with gender and diversity policies, all (12 out of 12) issuers had at least one female director on the board of directors, and 50% (6 out of 12) had females making up at least 25% of the board of directors, compared with 91.7% (44 out of 48) and 29.2% (14 out of 48) of TSX 60 issuers without gender or diversity policies. Among Completion Index issuers with gender and diversity policies, 73.3% (11 out of 15) had at least one female director, and 20% (3 out of 15) had females making up at least 25% of the board, compared with 58.2% (96 out of 165) and 12.1% (20 out of 165) of Completion Index issuers without such policies. Among SmallCap Index issuers with gender and diversity policies, 58.3% (7 out of 12) had at least one female director and 25% (3 out of 12) had females making up at least 25% of the board, compared with 41.1% (79 out of 192) and 5.7% (11 out of 192) of SmallCap Index issuers without such policies.

Although the consensus among securities regulators and the majority of market participants to date has been to resist hard targets for the representation of women on boards, we observe that among those issuers that do have a policy or guidelines regarding the representation of women on boards or diversity, 37.5% have also included gender or diversity targets, and the presence of such targets appear, at least in part, to contribute to a relatively higher level of representation of women on boards, at least among larger TSX-listed issuers.

For example, where targets have been fixed for female representation on boards, they generally range from 25% to 50%, with the most common targets at the 25% to 33% level . Among issuers that had disclosed targets or quotas for female representation, on average about 24.7% of the boards were made up of women, compared with only 10.4% on average for issuers that had no gender targets or quotas.

Gender and diversity targets also appear to have a positive effect on female directorship, increasing the average proportion of female board directors. Among issuers that had targets or quotas for female representation, on average 24.7% of the board of directors was made up of women, compared with 10.4% on average for issuers that had no gender targets or quotas.

AVERAGE PERCENTAGE OF FEMALE DIRECTORS FOR COMPOSITE AND SMALLCAP INDEX ISSUERS WITH AND WITHOUT GENDER AND DIVERSITY QUOTAS



Despite some of these trends, we anticipate that fixed targets or quotas will continue to be exceptional, rather than the norm, at least in the near term. It remains to be seen, however, whether the Final Disclosure Rule will prompt more TSX-listed issuers to adopt some form of gender or diversity policy and if, as a result, the level of female representation on boards and in executive positions of TSX-listed companies will continue to rise at the pace observed in 2013 and 2014.

One issue that boards will need to confront in the coming months is whether they should adopt some form of diversity policy or guidelines in response to the recently adopted Final Disclosure Rule. In September 2014, we hosted a panel discussion for leaders of Canada's public companies concerning leadership diversity. A key component of the discussion included the exchange of views about what kind of policy, if any, issuers should consider implementing.

According to Professor Richard Leblanc, a leading academic in this area who participated in our panel, any policy should include a definition of the meaning of "diversity" for the issuer (including diversity beyond just gender) and should be "SMART" – that is, its content should be specific, measurable, achievable, relevant and time-bound. However, boards should be cautious not to attempt to develop overly detailed policies in the short term while they are still evaluating their needs and objectives, particularly when setting any voluntary targets. In terms of targets, many commentators also caution that having only one female director does not result in meaningful improvements to the board effectiveness that is expected when boards have two, or ideally three, female directors. Boards should also consider tying any diversity objectives with compensation, and must also ensure that such policies are integrated with the issuer's other governance practices, including in relation to any term limits, retirement policies and overboarding restrictions. At our September 2014 panel discussion, many experienced directors on public company boards and thought leaders in this area suggested that boards that do not have any diversity policies or guidelines in place consider establishing mission statements or guidelines in the near term. They should also allow themselves time to develop specific milestones and objectives over the longer term to ensure that any policies adopted are appropriate for the company and set achievable and realistic goals that fit their particular circumstances. Boards must also consider how such policies will be overseen and enforced, and how to facilitate the implementation of any established objectives, including whether to remove some existing directors or increase the board size.

For more details concerning the key developments in leadership diversity in Canada, as well as helpful insights as to what boards should do next and examples of diversity disclosure used by other issuers in Canada and abroad, please see Davies' September 2014 publication *Davies Insights: Women on Boards*[7] and Davies' October 15 bulletin *Women on Boards and in Senior Management: Final Disclosure Rules Released*.[8]

In the coming months, boards should assess whether they should adopt some form of diversity policy or guidelines in response to the adoption of the Final Disclosure Rule.

NEXT STEPS AND CONSIDERATIONS FOR BOARDS

With the enhanced disclosure requirements under the Final Disclosure Rule coming into effect on December 31, 2014, we expect to see more proxy circular disclosure regarding issuers' diversity policies and practices, and more women serving in key leadership positions on boards and in senior management positions. However, as indicated above, the initiatives are not likely to stop

7 http://www.dwpv.com/en/Pages/~/media/Images/Microsite/Board_Diversity/Women_on_Boards_Final_Full.ashx.

8 http://www.dwpv.com/en/Resources/Publications/2014/Women-on-Boards-and-in-Senior-Management-Final-Disclosure-Rules-Released.

there. In the medium- to long-term, there may be calls for additional reforms to encourage diversity on boards and in management more broadly.

For example, in mid-2014, the federal Status of Women Minister Kellie Leitch announced that she plans to push corporate Canada to boost the number of women on their boards to 30% – nearly double the current level – within five years. The voluntary target proposed by Minister Leitch is one of several recommendations contained in *Good for Business: A Plan to Promote the Participation of More Women on Canadian Boards*[9] a report prepared by the federal Advisory Council for Women on Boards. Although the proposed target would be voluntary, Minister Leitch has indicated that she intends to back it up with monitoring, moral suasion and political pressure. Other developments in the area of gender diversity suggest that there may already be a fair bit of momentum toward more aggressive targets being promoted in the coming years.

In the meantime, there are several steps that a board of a Canadian issuer should consider taking:

- Carefully consider and evaluate what, if any, steps and policies have been adopted, or should be adopted, in order to foster diversity on the board and maximize the effectiveness of the board and decision-making.
- Regularly evaluate the effectiveness of the board, its committees, their respective leaders and individual directors, as well as the issuer's board renewal and director selection process.
- Start positioning itself to provide the enhanced annual disclosure required by the Final Disclosure Rule.
- Consult with advisers to craft the appropriate policies or processes that best meet the needs of the business, and to prepare accurate disclosure reflective of those policies and processes.

While it is too soon to determine the precise effect of the Final Disclosure Rule on issuers and their boards, it is clear that monitoring and evaluating the effectiveness of boards and individual directors will continue to be a major focus of Canadian and international regulators, investors, proxy advisory firms and other stakeholders.

9 http://www.swc-cfc.gc.ca/initiatives/wldp/wb-ca/wob-fca-eng.html.

Board Renewal Issues: Term Limits and Retirement Policies

Board renewal continues to be an area attracting the attention of Canadian regulators, investors, proxy advisory firms and shareholder advocacy groups like CCGG, all of which remain focused on maximizing board effectiveness and accountability. Within the broader topic of board renewal, director term limits and mandatory retirement policies have been an area of particular focus.

THE BOARD RENEWAL DEBATE

Debate continues about whether there should be some form of limits on the number of years an individual serves on a board. Term limits and retirement policies are touted by some as contributing to the effectiveness and accountability of boards, by ensuring continuous refreshment. In this camp, proponents argue that such limits reinforce independence of the board from management, on the theory that long-serving directors may become complacent or "too cozy" with management, thereby reducing their ability to operate independently. Proponents of these policies also promote them as an effective means to accelerate turnover and to remove underperforming directors, which in turn also creates opportunities for allowing renewal and greater diversity on boards.

On the other side of the debate are those who advocate allowing issues relating to directors to be dealt with by a strong chair, thoughtful governance committee and robust assessment processes, all of which are viewed as better mechanisms for ensuring independence, accountability and board effectiveness. In this line of thinking, long tenure on boards is not per se a problem to be rectified, but an issue to be considered to determine whether it enhances or inhibits board effectiveness.

CCGG's updated policy – *Building High Performance Boards* – released in August 2013 advocates companies improving the composition of their boards to increase board effectiveness; however, under the same policy, CCGG indicates that a high-performance board has experienced, knowledgeable and effective directors. With regard to renewal of boards, CCGG expects boards to ensure that they are renewed at an appropriate rate. It stresses, however, that boards should focus on striking a balance between the need for experienced directors who have a deep knowledge of the corporation while also ensuring that directors maintain a fresh perspective when assessing management and its recommendations. To achieve this balance, CCGG indicates that boards may wish to impose an upper limit on the amount of time an individual may serve; but it emphasizes that a superior method of ensuring appropriate board renewal is having a robust assessment process for every director whereby the board acts on the results of the assessment. According to CCGG and others aligned with this approach, robust assessment processes better target underperforming directors than do arbitrary term limits or retirement ages.

ISS's U.S. proxy voting guidelines recommend voting against proposals to limit tenure of outside directors through mandatory retirement ages or term limits, although with boards whose directors' average tenure exceeds 15 years, ISS will scrutinize them for independence from management and for sufficient turnover. Similarly, Glass Lewis has expressed that director age and term limits typically are not in shareholders' best interests and are often used by boards as a crutch to remove board members who have served for an extended period of time. Despite Glass Lewis's position against term and age limits, if a board does adopt such limits, Glass Lewis believes that the board should follow through on those policies and not waive the limits. Glass Lewis has also indicated that it will consider recommending that shareholders withhold votes from members of nominating and/or governance committees if the board waives such limits, subject to certain exceptions, such as when such waiver is done with a reasonable explanation, like the consummation of a major corporate transaction.

To date, neither Canada nor the United States have adopted rules or guidelines regarding director tenure. In Canada, the recently released Final Disclosure Rule (discussed above under "Recent Developments in Leadership Diversity") only requires issuers to disclose whether or not they have adopted term limits or other mechanisms of board renewal. Similarly, corporate governance watchdogs, regulators and shareholder advocacy groups in North America have, in general, tended to either be resistant to or, at least, not advocates of, the imposition of retirement policies or strict term limits on public companies. Rather, the general trend has been to advocate for robust assessment processes to ensure appropriate board renewal.

RETIREMENT POLICIES

Retirement policies with upper age limits are one means of generating board renewal. On the basis of an analysis of available data for issuers on the Composite Index and the SmallCap Index in 2013 and 2014, we observe that the percentage of issuers on the Composite and SmallCap indices that disclosed retirement policies increased slightly from 23.1% in 2013 to 24.2% in 2014. Not surprisingly, TSX 60 issuers had the highest incidence of retirement policies at 53.3% in 2014, although we note that this was a decrease from 58.3% in 2013. From 2013 to 2014, the percentage of Completion Index issuers with retirement policies increased from 23.1% to 26.1%; the SmallCap Index had the lowest percentage of issuers with retirement policies, although this number also increased from 10.3% in 2013 to 13.7% in 2014.

Despite the rise in retirement policies, in 2014 several issuers abolished pre-existing retirement policies. For example, Barrick Gold Corporation disclosed in its 2014 proxy circular that its mandatory retirement policy had been abolished on the basis that "the Board determined that it is in the best interests of the Company not to have a mandatory retirement requirement for directors [and rather] the Governance Committee and Nominating Committee, in consultation with the Lead Director, oversees a rigorous annual assessment of the Board, the committees of the Board, and each director to assess overall performance of the Board and to measure the contributions made by the Board as a whole, by each committee and by each director".

Similarly, Canadian Pacific Railway Ltd. removed its mandatory retirement age in 2014, explaining in its proxy circular that "the Board determined that a mandatory retirement age was not appropriate in the context of the Corporation. The Board, instead, implemented a more comprehensive assessment process that evaluates the performance, skills and contribution of each director on an annual basis which the Board believes is the preferable route to Board refreshment". In 2014, Manulife Financial Corporation also replaced its mandatory retirement age with term limits "to balance the benefits for experience and the need for renewal and new perspectives".

Although the incidence of issuers on the Composite Index, Completion Index and SmallCap Index with retirement policies showed a modest increase in 2014 over 2013, we also observe that for those issuers with retirement policies, the average mandatory age continues to be 70 years or older. For example, for Composite Index and SmallCap Index issuers, the average mandatory retirement age for those with retirement policies was 72.1 years. Of those issuers that disclosed retirement policies in 2014, 93.8% of TSX 60 issuers and 94.9% of Composite Index issuers had a mandatory retirement age of 70 or older. Similarly, 92.9% of SmallCap Index issuers with retirement policies had a mandatory retirement age of 70 or older. In addition, while some issuers have elected to have such retirement policies, in several instances they reserve some discretion to the board or a committee to permit the director to remain on the board for a period of time after reaching the threshold age in certain circumstances, such as where the loss of the director would impair the board's ability to act or would result in the loss of a needed independent director.

TERM LIMITS

Although term limits are not common in Canadian public companies, we observe some examples and some investors continue to urge boards to limit board tenure through term limits or otherwise. Outside North America, a growing number of countries have adopted or have proposed adopting tenure-related guidelines or restrictions, most commonly in the form of independence requirements. For example, regulation guidelines in France, which are among the most stringent, provide that directors no longer qualify as independent if they have served on a board for more than 12 years. Under France's *Corporate Governance Code*, a director that is non-independent is considered to be related to management and therefore does not meet the criteria to serve as an independent director, including on audit committees. In Hong Kong and the United Kingdom, although mandatory term limits are not in place, both regulators recommend a nine-year term limit, but permit longer tenure provided that the board discloses annually its reasons for determining that the applicable director is still independent.

Most recently, the Australia Stock Exchange Governance Council proposed amendments that would have tightened the rules surrounding director tenure. Specifically, the amendments would have required a company to disclose the length of service of each director and if a director served for more than nine years, she may no longer be considered independent. Ultimately, the Australian regulators backed away from the proposal, reportedly from pressure from several companies. While the final version of Australia's new corporate governance guidelines reference tenure limits, tenure is only one factor to be considered in assessing a director's independence.

% Percentage of Issuers Disclosing Term Limits

26.7%

TSX 60

In 2014, for those issuers on the Composite Index and SmallCap Index that disclosed information about term limits (which we note is currently not a required disclosure), 31 or 8.3% of such issuers disclosed they had term limits. Among TSX 60 issuers, 26.7% disclosed they had term limits, compared with 12.1% of Composite Index issuers, 7.2% of Completion Index issuers and 2.9% of SmallCap Index issuers. Companies with mandatory term limits in 2014 include TELUS Corporation, Just Energy Group Inc., CI Financial Corp., Maple Leaf Foods Inc, BCE, Inc., Enerflex Ltd., Metro Inc., Enbridge Inc., Canadian Imperial Bank of Commerce and several other major Canadian banks, as well as Sun Life Financial Inc. and certain other major insurance companies. Some of these companies also had retirement policies in place, in addition to term limits, which tends to be rare. For example, in 2014, a total of 18 companies, representing 4.8% of all Composite Index and SmallCap Index issuers, disclosed having both retirement policies and term limits in place.

For those that have disclosed term limits, the average limit is approximately 13.2 years, with a significant proportion of those being fixed at 12 or 15 years. On the basis of the foregoing trends, the case for term limits has not yet been made, but the debate is likely to continue. In addition, with the continued focus on gender diversity, board renewal and maximizing board effectiveness among public company boards, including under the Final Disclosure Rule that comes into effect at the end of December 2014, we may witness more companies adopting some form of tenure policy in the coming years, as one means for promoting diversity and ensuring board turnover and refreshment.

NEXT STEPS AND CONCLUSIONS ON BOARD TENURE

Term limits and formal retirement policies may help refresh stagnant boards and help to increase diversity in the leadership of Canada's public companies; however, in our view, director tenure remains an issue that is best left to boards to address individually, rather than through fixed rules or regulations. Although there are some proponents of such policies, and such policies may provide benefits to certain issuers that have elected to adopt them, it appears that to date, and particularly in North America, the consensus is against fixed tenure policies. Instead, the ideal mechanism is to ensure that a company has a well-functioning and independent board, without having to sacrifice high-quality directors, through a robust assessment process that requires boards, committees and individual directors to be evaluated regularly.

It remains to be seen whether the disclosure now required of Canadian issuers concerning term limits under the Final Disclosure Rule will prompt more issuers to adopt mechanisms to foster board renewal. Under the Final Disclosure Rule, TSX-listed and non-venture issuers will now be required to include in their annual proxy circulars or information forms disclosure of any director term limits or other mechanisms of board renewal adopted, or to provide an explanation for their absence. Mandatory term limits were not proposed. That said, the enhanced comply-or-explain disclosure model may prompt a rise in the number of TSX-listed companies that find themselves pressured to adopt some form of board renewal practices.

Boards and governance committees should continue to monitor developments and further debate on the relative pros and cons of tenure policies. Importantly, they should ensure that in the absence of renewal policies, the board and/or governance committee has comprehensive and effective assessment procedures in place to ensure ongoing evaluation of the effectiveness of the board, its committees and each individual director.

02 Executive and Director Compensation

02

Executive and Director Compensation

Executive and Director Compensation

The compensation practices of Canadian issuers continue to be a major focus in 2014. In this chapter, we examine the trends in the way companies compensate their senior management and directors in an effort to foster effective corporate governance and to effectively incentivize public company leaders to act in the interests of the company and its shareholders.

How Are Directors Compensated?

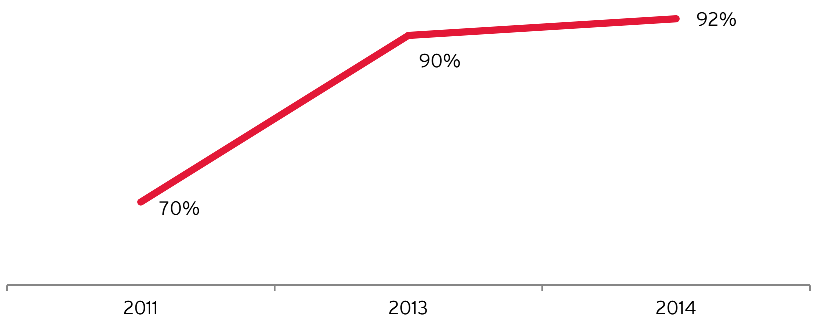
Under Canadian corporate law, directors have the authority to determine their own compensation, absolved from conflict of interest rules that would otherwise apply to matters in which they have a personal interest. In most cases, a director receives an annual retainer, plus a fee for each meeting she attends (referred to as a *per diem*, which is a meeting fee or attendance fee). In one quarter of the cases (one-third in 2013), issuers on the Composite Index and SmallCap Index pay their directors a flat fee, with no additional attendance-related fee. On the TSX 60, the portion of issuers with flat-fee director compensation structures is slightly higher at 32% (38% in 2013).

It is also common for directors to receive some form of share-based compensation. In some cases, directors may choose to have some or all of their cash compensation paid out in shares (or as discussed below, some type of phantom stock unit). In other cases, the share-based compensation is in addition to their retainers and *per diems*. Directors who are also officers or employees of the issuer (such as the CEO) typically do not receive board compensation in addition to their executive compensation.

RETAINERS

The annual retainer is generally intended to compensate directors for committing themselves to service on the board and for much of the board-related activity that occurs outside meetings (and is therefore not covered by the *per diem*). Directors may also receive an additional retainer for committee membership.

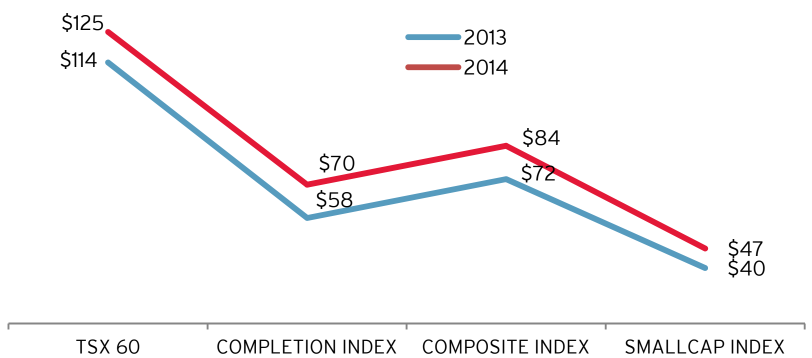
PERCENTAGE OF TSX 60 DIRECTORS RECEIVING RETAINERS OF AT LEAST $50,000 PER YEAR



The percentage of TSX 60 directors receiving retainers of at least $50,000 per year has been steadily growing, from 70% in 2011 to 90% in 2013 and 92% in 2014. The percentage of TSX 60 directors receiving retainers over $100,000 per annum rose from 40% in 2011 to 65% and 62% in 2013 and 2014, respectively. A similar upward trend is observed among the rest of the Composite Index issuers. While in 2011 over 75% of directors on the Completion Index received annual retainers of $50,000 or less, that percentage decreased to 57% in 2013 and 48.9% in 2014, indicating that now more than half of issuers on that index pay retainers above the $50,000 mark. On the SmallCap Index, the proportion of directors who receive annual retainers of $50,000 or less also decreased from 78% in 2013 to 67% in 2014.

The table below demonstrates the upward trend in the average amount of retainers for each of the TSX 60, Composite, Completion and SmallCap indices from 2013 to 2014.

AVERAGE RETAINER AMOUNTS (IN $ THOUSAND)



BOARD CHAIR RETAINERS

The board chair typically receives a larger annual retainer than other directors, reflecting the amount of additional time that the chair is expected to invest in planning and chairing meetings and in coordinating with management on behalf of the board.

Chairs of TSX 60 Issuers:

- The percentage of chairs who are paid more than $550,000 a year increased from 5% in 2013 to 6.7% in 2014.
- The proportion of chairs who are paid retainers of more than $350,000 increased from 23% in 2013 to 30% in 2014.
- In 2014, most chairs continued to be paid annual retainers of at least $250,000, but that percentage increased slightly from 58% in 2013 to 61.7% in 2014.

Chairs of Completion Index Issuers:

- The number of chairs who received an annual retainer over $350,000 remained at six from 2013 to 2014.
- The percentage of chairs who received less than $100,000 remained relatively constant (56% in 2013 and 52% in 2014).

Chairs of SmallCap Index Issuers:

- The percentage of chairs receiving no additional compensation decreased from 35% in 2013 to 28% in 2014.
- The percentage of SmallCap Index issuers receiving over $50,000 remained relatively constant year over year (46% in 2013 and 45% in 2014).

6.7%

TSX 60

CHAIRS PAID MORE THAN $550,000

SIX

COMPLETION INDEX

CHAIRS RECEIVED AN ANNUAL RETAINER GREATER THAN $350,000

ATTENDANCE FEES

An attendance fee (or meeting fee or *per diem*) is an amount paid to a director for each meeting that she attends. The average *per diem* amount for the Composite Index and SmallCap Index issuers is climbing above the $1,000 mark ($1,064 in 2013 and $1,133 in 2014). Some issuers pay committee chairs an additional *per diem* if they are engaged in committee work between meetings or may pay a director a *per diem* if the director takes on a special assignment. Some issuers also pay a travel fee to compensate directors for their time if they have to travel a significant distance to attend meetings of the board or committees.

AVERAGE BOARD ATTENDANCE FEES

SHARE-BASED COMPENSATION

Directors may receive some type of share-based compensation either in lieu of cash (if they so choose) or in addition to cash payments. For some years now, the investor community has generally been against directors receiving options, believing that options align the interests of directors with the interests of management more than shareholders. In line with this trend, granting options to directors is now unusual among large Canadian issuers: this year, only one issuer on the TSX 60 disclosed that it had granted options to directors (compared with three issuers in 2011 and two issuers in 2013). Although options continue to be used by smaller issuers for whom it may often be difficult to pay directors entirely (or at all) in cash, we are witnessing a continued decline in this practice: the percentage of Completion Index companies issuing stock options to directors decreased from 34% in 2013 to 21% in 2014 (37% in 2011); on the SmallCap Index, the decrease was from over 50% in 2011 to 46% in 2013 and 31% in 2014.

Deferred Share Units (DSUs) continue to be the most common form of share-based compensation for directors of TSX 60 issuers (87% in 2014 and 85% in 2013). The use of DSUs among the smaller issuers is less prevalent but has witnessed a steady increase over time (for Completion Index issuers, 50% in 2011, 58% in 2013 and 59% in 2014; and for SmallCap Index issuers, 26% in 2011, 36% in 2013 and 41% in 2014).

DIRECTOR SHARE OWNERSHIP REQUIREMENT

It has become typical for issuers to adopt share ownership guidelines requiring directors to own shares or receive share-based compensation, such as DSUs, with a value equal to a multiple of their annual retainers. This practice has been fully adopted by TSX 60 issuers for two consecutive years now, and as demonstrated in the chart on the right, we are observing a steady increase in the rate of adoption by smaller issuers. The same upwards trend is evident vis-à-vis the ownership multiple requirement, which in 2014 is 3.93x for TSX 60 issuers, 3.57x for Completion Index companies and 3.49% for the SmallCap Index. The average number of years to achieve the director share ownership requirement in 2014 was 4.77 for the TSX 60, 4.07 for the Completion Index and 3.88 for the SmallCap Index.

Ownership Multiple Requirement (expressed as a multiple of the retainer)

	TSX 60	Completion Index	SmallCap Index
2014	3.93	3.57	3.49
2013	3.88	3.37	3.37
2011	3.57	3.16	3.12

Smaller TSX issuers have a lower adoption rate of DSU ownership requirements, lower share ownership multiple requirements and a shorter time period to achieve the share ownership requirement, compared to larger issuers.

CEO Compensation Issues

CEO compensation is typically set by a fully independent compensation committee or by the full board on the recommendation of that committee. Compensation committees will often retain expert compensation consultants to provide comparator analysis. Decisions about CEO compensation are also influenced by the guidelines established by proxy advisory firms such as ISS and Glass Lewis.

Canadian securities regulation requires significant disclosure about executive compensation, with particular emphasis on CEO compensation. Typically, a CEO will receive a salary, cash bonus and stock-based long-term compensation. Other forms of compensation, such as car allowances, insurance and other benefits and perquisites, are also provided.

CASH-BASED COMPENSATION

In 2014, we saw a consistent increase in the reported average cash compensation (salary plus bonus) paid to CEOs of issuers on all indices. The average CEO cash compensation for TSX 60 companies increased by 11% from that disclosed in 2013. The compensation of CEOs of issuers on the Completion Index increased by 15%. CEO cash compensation of SmallCap Index issuers also increased, although by a more modest 5%. On each of these indices, the split between base salary and bonus remained relatively constant year over year (40% on the TSX 60, 41% on the Completion Index and 55% on the SmallCap Index).

Average CEO Cash Compensation (in $ million)

	2014	2013	2011
TSX 60	$3.06	$2.76	$2.88
Completion Index	$1.54	$1.34	$1.37
SmallCap Index	$0.87	$0.83	$1.22

STOCK-BASED COMPONENTS

In addition to base salary and bonus, CEOs are typically awarded some form of stock-based compensation that may be subject to time-vesting, performance-vesting or both. CEOs receive share-based compensation in a variety of forms. Options and deferred share units (most commonly in the form of restricted share units (RSUs)) are the most common form of share-based compensation for CEOs. Over the last two years, the practice of granting options to CEOs by issuers on the Composite Index and the SmallCap Index combined has been steadily declining (70% in 2011, 66% in 2013 and 58% in 2014). On the TSX 60, this practice decreased from 82% in 2013 to 77% in 2014. Sixty-two percent of issuers on the Completion Index and 50% of companies on the SmallCap Index granted options to their CEOs in 2014. Grants of RSUs declined between 2011 and 2013, but in 2014 bounced back slightly from 32% to 35%.

CONCERNS OVER RISING EXECUTIVE COMPENSATION

The upward trend in CEO pay levels has been a concern for some corporate governance observers. In response to concerns over the gap between CEO compensation and workers' pay, in the fall of 2013 the U.S. Securities and Exchange Commission (SEC) proposed a requirement that U.S. public companies disclose (i) the median of the annual total compensation of all employees of the issuer, except the issuer's CEO (or equivalent); (ii) the annual total compensation of the issuer's CEO (or equivalent); and (iii) the ratio of those two amounts. The rule will not apply to foreign private issuers that file annual reports and registration statements on Form 20-F or companies that file annual reports and registration statements on Form 40-F using the Canada-U.S. multijurisdictional disclosure system. Although the comment period for the proposed rule ended in December 2013, a final rule has not yet been adopted.

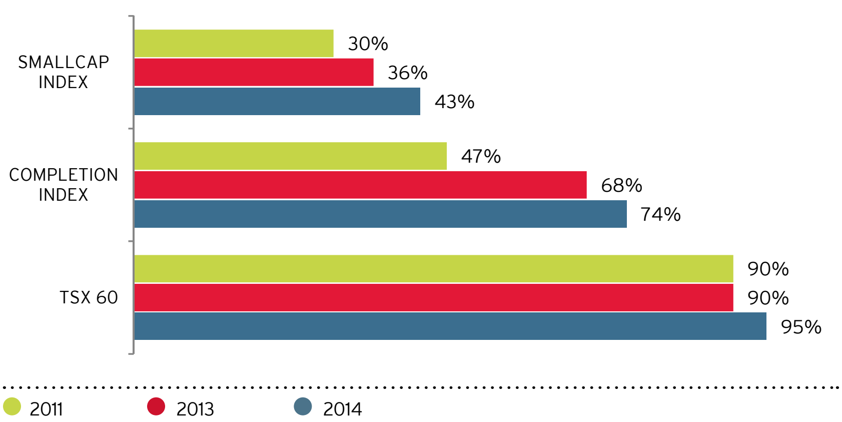
In the European Union (EU), a draft new proposal would require a binding vote on CEO pay ratios. If adopted, the proposal would require over 10,000 listed companies to disclose clear, comparable and comprehensive information on their remuneration policies and how they were put into practice. Company pay policies would be required to indicate the maximum executive compensation, and explanations will be required as to how each company's executive team contributed to its long-term interests and sustainability. In addition, companies will need to explain how the pay and employment conditions of employees were taken into account when setting the executive pay policies, including disclosure of the ratio of CEO pay to the average employee. The proposal is still in draft stage and is facing significant opposition.

In Canada, institutional investors and proxy advisory firms have been silent on this issue. However, some Canadian banks have, in their 2014 proxy circulars, addressed vertical pay comparisons as a factor that has been given consideration. Issuers should be aware of this issue and continue to monitor the response of the CSA and the Canadian governance community to these developments in the United States and Europe.

CEO SHARE OWNERSHIP REQUIREMENTS

The vast majority of TSX 60 issuers require their CEOs to hold shares. Although this number falls significantly for issuers on the Completion Index and SmallCap Index, the chart below demonstrates a significant upward trend by issuers in those indices. The number of shares that CEOs are required to hold is generally a multiple of their salary, a formula that has remained relatively constant since 2011. The average multiple this year was 4.7x (4.6x in 2013 and 4.5x in 2011) for TSX 60 companies, compared with 3.4x (3.3x in 2013 and 3.2x in 2011) for Completion Index companies and only 3x (3x in 2011 and 2013) for SmallCap Index issuers.

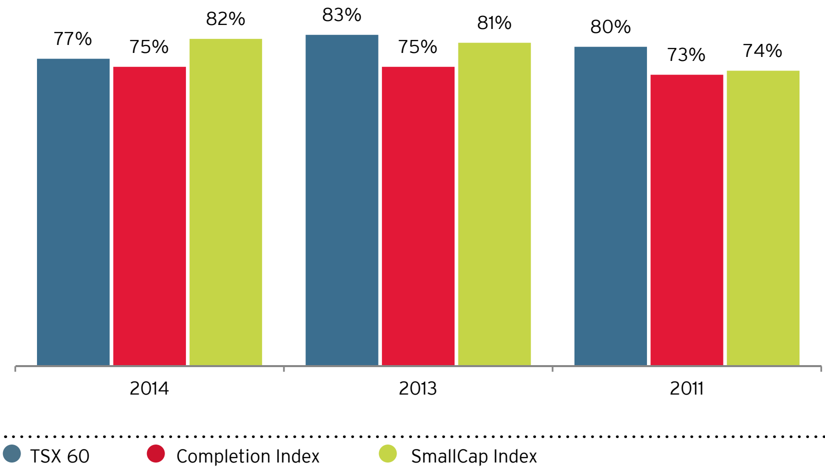
SHARE OWNERSHIP REQUIREMENTS



CHANGE OF CONTROL CLAUSES

Most issuers on the Composite Index and the SmallCap Index contract with their CEOs to provide them with payments upon a change of control. Substantially all change of control arrangements are "double trigger", requiring both a change of control and the termination of the executive's employment following that change of control. Single-trigger change of control arrangements are now rare.

CHANGE OF CONTROL PROVISIONS

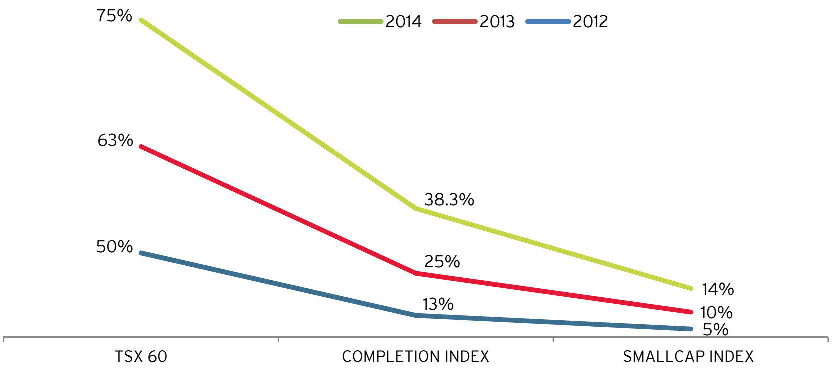


Consistent with prior years, change of control arrangements are in place for over three-quarters of the issuers reviewed. The change of control payments generally range from 200% to 250% of the executive's cash compensation (base and bonus), depending on the size of the issuer. On average, these payments are 2.33x cash compensation for TSX 60 issuers, 2.15x for Completion Index issuers and 2.04x for SmallCap Index issuers.

CLAWBACKS

Clawback provisions require the CEO to either repay some or all of the bonus or relinquish some or all of the equity-based award in situations in which the award would have been lower if based on a subsequent restatement of the financial statements that the company was required to do, or in cases of gross negligence, intentional misconduct or fraud.

PERCENTAGE OF ISSUERS WITH CLAWBACKS



The upward trend in the use of clawback provisions related to the payment of bonuses and/or stock-based compensation that we observed in 2013 continued in 2014. The percentage of issuers with clawbacks in each of 2011, 2013 and 2014 was 50%, 63% and 75% on the TSX 60, 13%, 25% and 38.3% on the Completion Index, and 5%, 10% and 14% on the SmallCap, respectively.

Say on Pay on the Rise

Consistent with the year-over-year rise in the incidence of "say on pay" shareholder votes on executive compensation in Canada since their introduction in 2009, and as predicted in our *Governance Insights 2013* report, 2014 proved to be another important year for say on pay votes, revealing a continued increase in the number of TSX-listed issuers holding such advisory votes and relatively consistent levels of positive voting results for such resolutions. For example, in 2014, 81.7% of TSX 60 issuers put say on pay resolutions forward, compared with 80% in 2013 and just over 50% in 2011. Similarly, say on pay is gaining increased traction among the relatively smaller issuers on the Composite and Completion indices, with approximately 47.9% of Composite Index issuers and 36.7% of Completion Index issuers putting forward say on pay resolutions, compared with 40.8% and 27.2% of such issuers, respectively, in 2013. As expected, the smallest issuers on the SmallCap Index continue to be slower to follow this trend; however, there was still a meaningful jump in the number of such issuers that held such votes in 2014, at 16.2%, up from 10.8% in 2013.

We expect this trend to continue into 2015 and beyond, both due to continued support for the practice and greater scrutiny on the alignment (or misalignment) of pay for performance by institutional investors, shareholder advisory firms such as ISS and Glass Lewis, and governance advisory groups such as CCGG.

SAY ON PAY RESOLUTIONS AND FREQUENCY

Say on pay resolutions in Canada continue to be in the model form recommended by CCGG in 2009, with slight variations. Say on pay votes on executive compensation are put forward to shareholders on an advisory basis, meaning that the outcome of the votes is not binding on the issuer, nor do they diminish the responsibilities of the board of directors for executive compensation decisions. This was also the case with the novel say on pay resolution for director compensation put forth by Sherritt, discussed further below.

ISS and Glass Lewis remain strongly supportive of say on pay votes and both firms are scrutinizing issuers' compensation practices. For example, in 2014, Glass Lewis introduced a new quantitative pay-for-performance model to rank issuers' pay for performance alignment, based on different performance-oriented metrics, such as total shareholder return, earnings per share growth and return on equity. On the basis of this new model, Glass Lewis frequently reports on misalignments between pay and performance, and we increasingly see ISS and Glass Lewis recommending that shareholders vote against say on pay resolutions where those misalignments or other problematic compensation practices exist.

As previously reported, while the holding of say on pay votes or their frequency are not mandatory in Canada, the more prevalent practice continues to be to hold such votes annually, rather than every three years, as is required in the United States.

IMPORTANT TRENDS IN SAY ON PAY IN 2014

Say on pay votes on executive compensation are becoming the norm among Canadian public companies. In 2014, we saw the first-ever say on pay vote on director compensation held by Sherritt International Corporation in the context of its highly publicized proxy contest with shareholder Clarke Inc. and its CEO George Armoyan.

Consistent with 2013, for those issuers that put say on pay votes forward to their shareholders in Canada, the resolutions enjoyed strong support from shareholders in 2014. For example, approximately 85% of such issuers received favourable shareholder votes of 85% or higher, while only about 15% received approval levels under 85%. Almost half of the TSX-listed issuers canvassed that held say on pay votes received more than 95% shareholder approval, again consistent with 2013 results.

Interestingly, while 2013 revealed only two issuers that held say on pay votes in Canada receiving relatively lower levels of support for their compensation practices and disclosure, in 2014 a total of six issuers had relatively lower levels of support (*i.e.*, less than 85% approval). However, in each instance, the issuers received at least 55% approval and in no case to date in 2014 has any TSX-listed issuer received less than 50% shareholder support. This is in stark contrast to 2013, when three TSX-listed issuers had failed say on pay votes, including Barrick Gold Corporation, as discussed further below. The issuers with relatively lower levels of support in 2014 were Crescent Point Energy Corp. (TSX:CPG) at 56.7%; BlackBerry Limited (TSX:BB) at 66.62%; AuRico Gold Inc. (TSX:AUQ) at 68.5%; Sherritt International (TSX:S) at 71.4%; Kinross Gold Corporation (TSX:K) at 75.8%; and Goldcorp Inc. (NYSE:GG) at 74.8%.

To date in 2014, *no* issuers that held say on pay votes in Canada received less than 50% shareholder support.

The trends we observed in 2014 among Composite and SmallCap indices issuers may well be due to the increased scrutiny being placed by investors, proxy advisory firms and other market participants on the relative alignment or misalignment on pay for performance. For example, proxy solicitation firm Kingsdale Shareholder Services Inc. (Kingsdale) reported in its *2014 Proxy Season Review* that numerous issuers received negative recommendations from Glass Lewis for their say on pay resolutions, due to a pay-for-performance misalignment identified in Glass Lewis's new quantitative pay-for-performance model referenced above. Kingsdale notes that this trend was especially evident in the gold industry, in which the collapse of gold prices in 2013 led to a deterioration of gold producers' financial metrics compared with other mining companies. This is also consistent with other trends observed by Kingsdale, including the fact that the average support for say on pay was largely weighted down by low vote results in the materials and energy sectors, both of which had average support below 90%. In contrast, as shown in a 2014 survey conducted by executive compensation consulting firm Global Governance Advisors of say on pay voting results at Canada's 100 largest companies, financial services companies recorded an average of 95% support for their say on pay votes.

Global Governance Advisors' survey also revealed that many of the companies with the lowest votes for their executive compensation plans in 2014 were those that had the weakest alignment between pay and performance in recent years. These results suggest that the alignment between pay and performance is increasingly becoming a focus of investors.

As noted above, BlackBerry Limited (BlackBerry) was among the six TSX-listed issuers canvassed that received one of the lowest levels of approval for its say on pay resolution in 2014. At its 2014 annual and special meeting of shareholders, only 66.6% of votes were cast in favour of BlackBerry's advisory executive compensation say on pay resolution. Consistent with the more general findings outlined above, the relatively low level of shareholder support was largely attributable to a compensation package estimated at approximately $85 million awarded in 2014 to Mr. John Chen who was then-newly appointed to BlackBerry as the Executive Chairman and Interim Chief Executive Officer. The substantial compensation award for Mr. Chen came at a time when BlackBerry's cash situation was deteriorating and the fiscal 2014 results for BlackBerry reflected reduced revenue, operating losses and negative earnings per share, making Mr. Chen's compensation, for many investors, excessive or inappropriate. Ultimately, BlackBerry saw its say on pay resolution approved by its shareholders, but it is noteworthy that executive compensation packages continue to fall under the scrutiny of investors and, where there is a misalignment or perceived misalignment in pay for performance, shareholders are willing to flex their muscles with negative say on pay votes.

We expect that the growth in say on pay will continue. We also expect that with the continued scrutiny over pay for performance, proxy advisory firms like ISS and Glass Lewis may show an increased willingness to recommend votes against issuers' compensation practices and disclosure (or members of the issuer's compensation committee if a say on pay vote is not held), with the result that the historically higher levels of shareholder approval witnessed in the past couple of years may start to decline.

BARRICK'S SAY ON PAY EXPERIENCE

As discussed in *Governance Insights 2013*, in 2013 Toronto-based gold miner Barrick Gold Corporation (Barrick) held its annual non-binding shareholder advisory vote on executive compensation, receiving only 14.8% of votes in favour, with the remaining 85.2% of votes cast against the resolution.

In response to the negative vote, and over the course of 2013, Barrick's Compensation Committee set out to re-design and implement a new executive compensation program to better align its executive compensation approach with the long-term interests of its shareholders and to reflect true pay-for-performance principles. Barrick reported in its 2014 management proxy circular that, as part of that process, "we engaged extensively with shareholders representing more than 30% of our outstanding Common Shares, to solicit their views on executive compensation and corporate governance practices".[10]

Following this review process, in March 2014 Barrick announced that it had introduced a new compensation program for 2014. The cornerstone of the revamped compensation program is a new compensation plan that measures senior executives on a publicly available long-term collective performance

10 Management Information Circular of Barrick dated March 21, 2014 for the annual and special meeting of shareholders of Barrick held on April 30, 2014, p. 6.

"scorecard", whereby senior executives are compensated having regard to metrics that Barrick believes will drive long-term shareholder value like shareholder returns, dividends and free cash flow. A significant portion of executive salaries are paid in performance-granted share units (PGSUs) that are converted into shares purchased on the market after a three-year vesting period. The shares received can be sold only when an executive leaves the company. The program, as described by Barrick, is based on the simple principle that management should be owners and was designed to align the long-term interests of executives and its shareholders. Among other features of the dramatically revamped compensation program, Barrick reduced the portion of compensation delivered in the form of annual bonuses for management executives, froze base salaries for its top five paid executives for 2014, implemented a clawback policy for incentive compensation and eliminated the granting of stock options to executives as incentive compensation, given their relatively short-term nature.

As a result of these significant changes, ISS recommended that its clients vote with the Barrick board at the 2014 meeting, including recommending a vote in favour of Barrick's new executive compensation plan and in favour of all of management's board nominees. The result was overwhelmingly positive, with each of management's board nominees receiving more than 90% of votes "for" their appointment, and just over 80% of shareholders voting in favour of Barrick's say on pay resolution.

In light of Barrick's negative say on pay experience in 2013, and the considerable efforts made by the gold miner to rework its executive compensation program for 2014, Barrick may have set the standard for other issuers that confront relatively lower levels of shareholder support for their compensation practices and disclosure. The Barrick say on pay experience shows that no issuer is immune to shareholder scrutiny of its compensation practices, and boards should be prepared to take meaningful steps if confronted with less than typical shareholder support for those practices.

SAY ON PAY FOR DIRECTOR COMPENSATION: THE NEXT EVOLUTION?

Another interesting development in 2014 was the introduction of the first-ever say on pay vote on director compensation held in Canada by Toronto-based nickel miner/energy producer Sherritt International Corporation (Sherritt) in the context of its proxy contest with 5%-shareholder Clarke Inc. and its CEO George Armoyan. By way of background, in December 2013, Clarke Inc. requisitioned a special meeting of Sherritt shareholders to vote on a reduction in the board size and the removal and replacement of certain directors. Mr. Armoyan announced his intention to stage a dissident proxy campaign to oust Sherritt's incumbent board in January 2014, proposing to reduce the size of the board and to appoint himself and two of his employees to the board. The chief allegation made in Clarke Inc.'s dissident circular was that management was enriching itself while failing to create shareholder value.

Subsequently, in March 2014, Clarke Inc. submitted four shareholder proposals to be included in the Sherritt management proxy circular to be disseminated before the annual and special meeting. One of these proposals was for an advisory say on pay vote on director compensation, on the basis that say on pay for executive compensation is "increasingly accepted as a right of shareholders" and they believed that it is "only logical to extend this concept to Boards of Directors since they are directly responsible to shareholders".

In its management proxy circular, acknowledging that there is no market practice in Canada or the United States of having a say on pay resolution for director compensation, Sherritt stated that in light of the proposal received from Clarke Inc., it was voluntarily putting forward such a resolution "this year" and planned to monitor market practice in this regard in the future. Similar to its say on pay resolution for executive compensation, Sherritt reminded shareholders in its proxy materials that the vote was advisory and not binding on the board of directors, but that its Board would review the results of the advisory vote and consider the outcome when considering future director compensation arrangements.

Both ISS and Glass Lewis backed Sherritt in the proxy campaign, recommending that their clients support all of Sherritt's director nominees by voting "for" each nominee, as well as voting in favour of the company's executive and director compensation say on pay resolutions. Sherritt proved successful in its contest with Clarke Inc., with all of the incumbent directors being re-elected, Mr. Armoyan's three nominees being defeated, and shareholders voting 72.8% in favour of the say on pay director compensation resolution.

Although the Sherritt say on pay director resolution was a significant development in 2014, we do not expect to see this become the norm, at least outside the proxy contest arena. However, the concept is not entirely without support. As noted by Sherritt in its 2014 proxy circular, CCGG indicates in its February 2011 *CCGG Director Compensation Policy* that "directors, as fiduciaries, should consider periodically seeking approval from their shareholders for directors' compensation". CCGG states this could be achieved by the approval from time to time of an annual aggregate limit for director compensation. While CCGG's current *Model 'Say on Pay' Policy for Issuers* does not provide for say on pay votes for director compensation, it is noteworthy that prior working drafts of that policy did contemplate holding such votes for both executives and directors, in the following form of model resolution:

> Resolved, on an advisory basis and not to diminish the role and responsibilities of the board of directors, that the shareholders accept the approach to *executive and director compensation* outlined in the report to shareholders of the [Human Resources] Committee of the board included in the Company's information circular delivered in advance of the [insert year] annual meeting of shareholders. [emphasis added]

Ultimately, the reference to "director compensation" in CCGG's final model say on pay policy and resolution was abandoned. However, in light of the CCGG *Director Compensation Policy* and the precedent set by Sherritt in 2014, it is possible that some issuers may face proposals or shareholder demands to hold, at least periodically, an advisory say on pay vote on director compensation. At minimum, issuers subject to proxy contests may start to witness the use of this tactic through shareholder proposals or meeting requisitions as leverage. In some ways, this would not be inconsistent with the requirements already in place for financial institutions regulated by the *Bank Act* (Canada), which are required to have a by-law fixing the maximum aggregate remuneration payable to directors within a prescribed period of time and such by-laws must be confirmed by a special resolution of the shareholders, as must any by-law amendments.

Notwithstanding the foregoing, there are sound reasons for not putting director compensation forward for shareholder approval, even on an advisory basis. First, director compensation is already extensively described in Canadian issuers' annual proxy materials and, if shareholders wish to express dissatisfaction with those practices, there exist ample opportunities for them to do so by voting against or withholding votes from the appointment of one or more board nominees, including members of the issuer's compensation committee. In addition, directors continue to be bound by strict duties that should minimize the risk of directors acting in their own self-interest when it comes to compensation matters.

Maintaining awareness of those duties is particularly important in light of this year's Ontario Court of Appeal decision released in July 2014 in *Unique Broadband Systems, Inc. (Re)*,[11] in which the Court upheld a trial decision and found that a CEO had breached his fiduciary duties as a member of the Board and its Compensation Committee in participating in a decision to grant certain executive compensation. In that case, the Unique Broadband Board, on the recommendation of its Compensation Committee comprising the CEO and two other directors, determined to trigger certain awards under an incentive-driven share appreciation rights (SARs) plan and to award special bonuses to senior management, in the context of the sale of the company's primary asset. Following this decision, a group of shareholders requisitioned a meeting at which

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the CEO was removed and the other directors on the Compensation Committee were not re-elected. The CEO commenced an action against Unique Broadband for wrongful termination and sought his payments under the SAR award and special bonus, as well as indemnification entitlements. The Court found that the CEO had breached his fiduciary duties, which included a "specific obligation to scrupulously avoid conflicts of interest with the corporation and not to abuse his position for personal gain", on the basis that the decision to award the SARs and special bonuses was self-interested and not in the best interests of the corporation. The CEO was also found ineligible for indemnification since he had not acted in good faith and in the best interests of the corporation. Importantly, the Court rejected the argument that the board's decisions were within a range of commercially reasonable decisions and protected by the business judgment rule. Because the CEO could not satisfy the preconditions of "honesty, prudence, good faith, and a reasonable belief that his actions were in the best interests of the company", the Court found that the business judgment rule did not apply.

In light of the above, issuers should ensure they have proper policies and processes in place governing executive and director compensation matters, including oversight by independent compensation and/or governance committees. Additionally, in light of the *Unique Broadband* case, directors should be careful to disclose any conflicts of interest. Note that mere disclosure of a conflict will not relieve a director of her duty to act honestly and in the best interests of the corporation. Maintaining a proper process for making compensation decisions and keeping records evidencing that process may also help foster better decision-making and reduce the potential for directors' actions on executive or director compensation decisions coming under scrutiny.

EMERGING COMPENSATION TRENDS AND GUIDANCE FOR BOARDS

The growth of say on pay is expected to continue receiving broad endorsement by a large segment of the investor community and their advisers. To the extent that boards have yet to at least consider whether it would be prudent to adopt a say on pay policy and practice, they will find themselves starting to lag behind other issuers and what many view as an expected best practice in corporate governance. The following are some steps that a board should consider:

- It should receive regular reports from the issuer's investor relations professionals about the feedback they are receiving from shareholders, including on the issuer's compensation practices in particular, and corporate governance policies and practices more generally.
- It should be aware of the recommendations of leading proxy advisory firms like ISS and Glass Lewis in this area, including these firms' increased use of quantitative metrics to track pay for performance and identify

misalignments in this area and the firms' increased propensity to make negative recommendations where perceived misalignments or problematic compensation practices are identified.

- It should consider receiving advice from a proxy solicitor about how investors are feeling more broadly about issues and about the perceived responsiveness of the issuer to investor views. Issuers that do not maintain a dialogue or other means of directly engaging with their investors should also consider implementing such procedures to facilitate ongoing shareholder communication.
- If a say on pay policy is not already in place, the board should consult with legal counsel as to the appropriateness of implementing such a policy and vote, having regard to the issuer's particular circumstances.

These steps will help a board avoid being surprised by shareholder discontent or activism in respect of its compensation practices and philosophy or by the results of a say on pay vote. Taking the time to at least consider and discuss the issues surrounding compensation and to engage with the issuers' shareholders when appropriate will also provide guidance on how best to anticipate investor concerns and respond before investors feel as though they must resort to more aggressive tactics.

03
Shareholder Voting Issues

03

Shareholder Voting Issues

Proxy Voting Reform Initiative and Developments

The problems with the proxy voting system in Canada have been discussed for a number of years. In 2010, we published Davies' paper *The Quality of the Shareholder Vote in Canada*,[12] which focused on and brought attention to the complex and opaque system through which shareholders cast their votes at shareholder meetings. Davies' paper, and several other reports and developments since then, have highlighted the irregularities and inaccuracies that can arise at shareholder meetings as a result of the flaws in the Canadian proxy voting system. These issues continued to attract the attention of regulators in 2014 and are expected to remain under scrutiny in the coming years.

Initiatives and developments in the area of proxy voting reform have made little headway in building the confidence of market participants.

CSA 2013 CONSULTATION PAPER

As discussed in *Governance Insights 2013*, in August 2013 the CSA issued a consultation paper reviewing the proxy voting infrastructure and seeking to outline a proposed approach to address the identified concerns.[13] The CSA paper highlighted several areas for discussion, including (i) whether the infrastructure adequately supports accurate and reliable vote counting; and (ii) whether a vote confirmation system should be introduced so that shareholders can be confident that their votes have been transmitted, received and counted at a shareholders meeting. Full details of the issues canvassed in the CSA paper and the issues associated with vote reconciliation and voting confirmation are set out in our *Governance Insights 2013* report and discussed further below.

Nearly all of the comments received in response to the CSA paper expressed dissatisfaction with the current regime and that dissatisfaction persists. Only Broadridge Investor Communications Corporation (Broadridge) and the Investment Industry Association of Canada maintain that the system is "not broken". Specific causes of concern with the current infrastructure are discussed in further detail below. Most commonly, commentators on the CSA paper included recommendations that earlier reconciliation of votes be required by intermediaries, that some form of end-to-end voter confirmation system be developed and that some oversight and/or independence standards be created in the proxy voting system.

12 http://www.dwpv.com/en/Resources/Publications/2010/Discussion-Paper-The-Quality-of-the-Shareholder-Vote-in-Canada.

13 See *Consultation Paper 54-401, Review of Proxy Voting Infrastructure* (CSA paper).

03 Shareholder Voting Issues

OSC 2014 ROUNDTABLE DISCUSSION

In January 2014, the OSC held a roundtable discussion that reinvigorated the attention of market participants on Canada's proxy voting infrastructure and raised the prospect for greater regulatory oversight of the processes and participants within this area. In particular, the OSC roundtable considered the issues surrounding vote reconciliation and confirmation, and solicited feedback and further discussion from a large group of participants, including issuers and investors, representatives of Broadridge, CDS Clearing and Depository Services Inc. (CDS), intermediaries, transfer agents and custodians. The OSC roundtable focused on some of the investments in technology and modified practices adopted by Broadridge and intermediaries to improve the vote reconciliation process. Broadridge made a presentation concerning a pilot voting confirmation system it had launched in the United States with selected issuers intended to provide end-to-end vote confirmation. While those responsible for the operation of the system claim to have adopted practices aimed at reducing voting irregularities, it was clear at the OSC roundtable that such initiatives have made little headway in building the confidence of market participants in the integrity and reliability of the system.

Participants asserted, among other issues, that the proxy voting system suffers from systemic issues that continue to compromise its integrity, including inadequate and inconsistent intermediary practices relating to the reconciliation of voting entitlements leading to "overreporting" (whereby an intermediary's records show more voting entitlements than are reflected in its CDS account) and "overvoting" (whereby the same share may be voted more than once); the absence of an end-to-end vote confirmation system to verify when beneficial holders' voting instructions have been received and recorded; and the lack of independent auditing procedures and regulatory oversight of participants to ensure accountability and integrity in the operation of the proxy voting system. Particular concerns raised include the following:

- **Intermediary Structure Complexities:** The multiple layers of intermediaries, different omnibus and mini-omnibus voting processes, and different reconciliation processes and voting streams used by intermediaries are cited as creating complications and gaps, as well as risks for overreporting and overvoting. For example, when votes cannot be reconciled, intermediaries apply different processes, resulting in the potential for some votes to be counted more than once and other votes, which cannot be reconciled, being excluded.
- **Multiple Service Providers:** The use of various service providers by issuers and investors in connection with proxy voting are perceived to create a lack of consistency, transparency and accountability. For example, in connection with any single shareholders' meeting, there may be several different

depositories, transfer agents, intermediaries, proxy agents, proxy solicitors and proxy advisory firms all playing a role, with some playing redundant or multiple roles.

- **Securities Lending Transactions:** Securities lending transactions, in which one party lends shares to another party, continue to create risks of overvoting and are a major area of concern. Participants frequently cited cases in which securities lending transactions have created multiple voting entitlements for the same shares, leading to either overvoting or tabulators discarding otherwise valid votes.
- **OBO/NOBO Distinction:** The distinction between OBOs and NOBOs, including questions surrounding the appropriateness of preserving the anonymity currently enjoyed by the relatively large class of OBOs, continues to be debated. Participants took issue with the different (and for many, largely archaic) mailing options and tabulation mechanisms used for each class of shareholders, as well as the use of different voting platforms for OBOs and NOBOs, rendering reconciliation and confirmation more difficult and, in some cases, impossible.
- **Inaccurate or Inconsistent Vote Reconciliation:** The lack of consistency and transparency in the voting reconciliation process, arising from the use of different tabulators and transfer agents and the application of discretion and presumptions by different tabulators, continues to be an area of concern. Issuers and investors both cited examples of votes that cannot be adequately reconciled being accepted on a "first in" basis until an aggregate limit is reached, with the rest then being discarded, or tabulators prorate voting positions by reducing the voting position of each shareholder. Ultimately, the result is that the final vote is not accurate, and shareholders do not actually know whether or not their vote was counted at a meeting.

PROXY VOTING REFORM: WHAT'S NEXT?

Despite the objectives of the CSA and OSC and many market participants in improving the proxy voting infrastructure in Canada, both the 2013 CSA paper and the 2014 OSC roundtable brought to light the starkly divergent views on the state of Canada's proxy voting system and the best means for addressing these issues. One notable observation from these consultations and discussions is how little the debate has evolved since the publication of our paper in 2010. While those responsible for the operation of the system have made efforts to improve it, the fundamental problems that we canvassed in 2010 are still largely unresolved, and doubts about the integrity and accuracy of the system remain.

Ultimately, the OSC's goal is to ensure that "every vote counts and no vote counts more than once". While this appears to be a simple objective, the

The fundamental problems that we canvassed in 2010 are still largely unresolved, and doubts about the integrity and accuracy of the system remain.

different interests and priorities of participants may make it difficult to achieve. That said, the OSC continues to take a leadership role in looking for ways to improve the proxy voting infrastructure. To that end, in the OSC *Notice 11-770, Notice of Statement of Priorities for Financial Year to End March 31, 2015*, the OSC has identified making progress on improving the proxy voting infrastructure as one of its priorities. The OSC indicates that it intends to publish a progress report with preliminary recommendations on the status of its review of the proxy voting system by December 2014 and will continue to review the feedback received on the CSA paper and the related OSC roundtable to target specific concerns and identify potential solutions, including through continued engagement with stakeholders.

Broader reforms to the proxy voting infrastructure are likely to be much farther down the road.

We do not expect that solutions are going to be easily come by, and we are far from fixing the problems. In the short- to medium-term, we may see Canadian regulators develop discrete rules to address inaccuracies created by securities lending transactions or other features of the proxy system, and perhaps may also see industry guidelines or recommendations to try to standardize the reconciliation practices of intermediaries. However, broader reforms to the proxy voting infrastructure are likely to be much farther down the road, as we expect stakeholders will continue to debate the existence and relative importance of the perceived flaws, how to tackle those flaws and which participants should be permitted to be at the table to implement and oversee those changes.

Recent Developments in the Role and Regulation of Proxy Advisory Firms

Consistent with 2013 developments we reported on, we saw a continued focus in 2014 on the role and regulation of proxy advisory firms, both in Canada and abroad. Proxy advisory firms like ISS and Glass Lewis continue to be perceived as wielding significant influence over corporate governance issues, including who sits on boards, how directors oversee their companies and compensate top executives and in respect of transformative transactions. A "no" recommendation from a proxy advisory firm can make the difference in close votes. Some market participants have expressed concerns that proxy advisory firms apply uniform practices or one-size-fits-all approaches to companies subject to their review, without having regard to their particular strategic, competitive or management situations. Another concern is that proxy advisory firms perform multiple functions for multiple constituents, by analyzing proxies and making voting recommendations to investors, while at the same time providing consulting services to issuers and others, creating potential conflicts of interest.

As a result of these perceived concerns, among others, as well as some evidence that proxy advisory firms do have a meaningful impact on the outcome of votes, particularly for many institutional investors that rely on their analyses and recommendations, in 2014 we saw the introduction of proposed guidance or regulations in Canada, the United States and the European Union that would result in varying degrees of increased disclosure and transparency about the methodologies and recommendations of proxy advisory firms and their business relationships.

CSA PROPOSED POLICY ON GUIDANCE FOR PROXY ADVISORY FIRMS IN CANADA

Following a consultation process, in April 2014 the CSA released for comment proposed National Policy 25-201 *Guidance for Proxy Advisory Firms* (Proposed Policy). The Proposed Policy would apply to firms that (i) analyze matters put to a vote at shareholders meetings; (ii) make vote recommendations; or (iii) develop proxy voting guidelines. Rather than strict rules or prescriptions, the Proposed Policy recommends "best practices" for proxy advisory firms.

The CSA has expressed that it believes that general guidelines are the best means of addressing the concerns of market participants, while respecting the private contractual relationship between proxy advisory firms and their clients. The CSA guidelines pertain to four broad areas of concern:

- **Conflicts of Interest:** The Proposed Policy states that proxy advisory firms are expected to identify, manage and mitigate actual or potential conflicts of interest. The suggested practices for proxy advisory firms in this area are (i) establishing written conflict of interest policies and procedures; (ii) designing internal safeguards and controls to monitor the effectiveness of such policies and procedures; (iii) establishing codes of conduct that set out standards of behaviour; and (iv) continually evaluating the effectiveness of such measures.
- **Vote Recommendations:** The Proposed Policy indicates that proxy advisory firms may consider establishing and, where possible and without compromising the proprietary or commercially sensitive nature of information, disclosing policies and procedures followed in issuing vote recommendations and describing the approach or methodologies used in this analysis. Furthermore, the policy recommends disclosure of the internal safeguards and controls used by the proxy advisory firm to increase the accuracy and reliability of vote recommendations.

Rather than strict rules or prescriptions, the Proposed Policy recommends best practices for proxy advisory firms.

- **Proxy Voting Guidelines:** The Proposed Policy encourages proxy advisory firms to establish written policies and procedures regarding their process for developing voting guidelines. The CSA indicates in the Proposed Policy that this process should include regular consultations with clients, market participants and the public.
- **External Communications:** Lastly, the Proposed Policy sets out a minimum list of information that the CSA expects firms to communicate to clients in their reports, including factual information and information that is derived from analytical models and assumptions. Advisory firms are encouraged to establish written policies and procedures governing their communications with clients, market participants, the media and the public.

The CSA also requested comments regarding the following issues: (i) whether the Proposed Policy will promote meaningful disclosure; (ii) whether the CSA should encourage proxy advisory firms to engage with issuers in determining voting advice; and (iii) whether the CSA should require that a client agrees to the proxy advisory firm's voting guidelines before the client receives voting recommendations.

Many issuers advocate for greater regulation of proxy advisory firms, whereas proxy firms and many investors resist regulatory oversight.

Comments were due on the Proposed Policy by July 23, 2014 and more than 50 responses were received. Many commentators expressed concerns that the Proposed Policy does not go far enough in addressing the key areas of concern. Commentators have indicated a desire for clearer regulation in certain areas. For example, senior issuers such as Goldcorp Inc. requested that the policy include a requirement that proxy advisory firms provide notice, or a draft report, to the issuer in advance of making a vote recommendation. This would allow for the detection and resolution of factual inaccuracies in the vote recommendation prior to its issuance.

The proxy advisory firms themselves, ISS and Glass Lewis, appear in favour of the proposed policy and are of the view that no further regulation is warranted. CCGG has also expressed a view that regulation of proxy advisory firms is not necessary. Rather, it supports proxy advisory firms' adoption of a voluntary code of best practices, perhaps similar to the best practices adopted by ISS and Glass Lewis in the European Union after discussions with the European Securities and Markets Authority.

To date, no further clarity has been provided by the CSA as to the next steps, and whether we may see a substantial revamping of the approach to the regulation of proxy advisory firms in Canada. Regulators outside Canada are taking different approaches, with some more inclined toward providing guidance, such as in the United States, and others more focused on developing stricter rules and disclosure requirements that would place more onerous demands on proxy advisory firms, such as those proposed in the European Union. These approaches are summarized below.

SEC 2014 GUIDANCE ON PROXY ADVISORY FIRMS IN THE UNITED STATES

On June 30, 2014, the staff of the SEC's Division of Investment Management and Division of Corporation Finance (SEC staff) issued guidance in Staff Legal Bulletin No. 20 regarding proxy advisory firms, in the form of 13 questions and answers. The SEC staff's guidance addresses two main topics of interest: (i) investment advisers' responsibilities in voting client proxies and retaining proxy advisory firms; and (ii) the availability and requirements of two exemptions to the proxy rules often relied on by proxy advisory firms.

In regard to the first category, the SEC staff recommends that investment advisers review their voting of proxies to ensure that it corresponds to the investment adviser's proxy voting policies, and review those policies annually. SEC staff further advises that investment advisers and their clients be afforded flexibility in determining the manner in which their clients' proxies are to be voted, with the exception that the voting be conducted in a manner that adheres to the SEC's *Final Rule: Proxy Voting by Investment Advisers* (proxy rule).

In the bulletin, SEC staff cautions that investment advisers should not blindly follow the voting advice of a proxy advisory firm. Rather, they should assess whether the proxy advisory firm has the capacity and competency to adequately analyze the proxy issues on which the adviser will be voting the client's equity securities. SEC staff also indicates that an investment adviser that has retained a proxy advisory firm to assist with its proxy voting responsibilities should implement policies and procedures that are reasonably designed to provide sufficient ongoing oversight of the third party to ensure proxies are voted in the best interests of its clients. If the investment adviser believes that the proxy advisory firm has based its recommendations on incorrect material facts, SEC staff recommends that the adviser take reasonable steps to investigate the error.

In respect of the second area of interest highlighted in the SEC staff's guidance, a proxy advisory firm is subject to proxy solicitation rules under the U.S. *Securities Exchange Act of 1934*.

However, a proxy advisory firm may be able to avail itself of a "solicitation exception" if it limits its activities to distributing reports containing recommendations and does not solicit the power to act as proxy for clients receiving the recommendations.

A proxy advisory firm may also be exempted under what is often referred to as the "business relationship exemption". This rule exempts the furnishing of proxy voting advice by any person to another with whom a business relationship exists, subject to certain conditions. According to SEC staff, the business relationship exemption is available if the person gives financial advice; discloses any significant relationship or material interests of the person in such matter;

The SEC guidance provides investment advisers with greater oversight of proxy advisory firms. Issuers' and shareholders' views concerning the appropriate level of regulation, if any, diverge.

receives no special commission or remuneration from any person other than the recipients of advice; and does not furnish the advice on behalf of any person soliciting proxies or a participant in a contested election. If a proxy advisory firm is required to provide notice of a significant relationship or material interest, the SEC staff advises that boilerplate language is insufficient; disclosure should enable the recipient to understand the nature and scope of the relationship or interest, including the steps taken, if any, to mitigate the conflict, and provide sufficient information to allow the recipient to make an assessment about the reliability or objectivity of the recommendation. Stating that information concerning the relationship is available upon request is *not* sufficient.

EUROPEAN UNION SHAREHOLDER RIGHTS DIRECTIVE

Unlike the approach proposed to date in Canada and the United States, the European Union seeks to go further and impose more onerous, prescriptive requirements on proxy advisory firms.

In April 2014, the European Commission published proposed revisions to the existing Shareholder Rights Directive to, among other things, provide greater oversight over and disclosure by proxy advisory firms.[14] On the basis of consultations and other steps taken by the EU Commission since 2010, the Commission identified the inadequate transparency of proxy advisory firms as one of the main issues of concern.

> **The amended EU Shareholder Rights Directive would require proxy advisory firms to adopt and implement measures to "guarantee that their voting recommendations are accurate and reliable".**

The European Commission noted that proxy advisory firms are not subject to any regulation at the EU level, and non-binding rules exist in only a few member states, such as the United Kingdom. The Commission views proxy advisory firms as sufficiently influential that in some jurisdictions they are the de facto "standard-setter" in corporate governance. Accordingly, the potential failure of those firms to incorporate local market and regulatory conditions into their methodologies, as well as concerns regarding conflicts of interest where the advisers also provide paid services to issuers, are perceived as shortcomings that the proposed revisions to the Shareholder Rights Directive are intended to address.

The amended Shareholder Rights Directive would require proxy advisory firms to implement measures to "guarantee that their voting recommendations are accurate and reliable", based on a thorough analysis of all the information that is available to them, and are not affected by any existing or potential conflict of interest or business relationship. The amended Directive would also require proxy advisory firms to disclose and maintain on their website information

14 *Proposal for a Directive of the European Parliament and of the Council amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EU as regards certain elements of the corporate governance statement*, European Commission, COM(2014) 213 final.

relating to the preparation of their voting recommendations, including the methodologies and models they apply; information sources used; how they take national market, legal and regulatory conditions into account; whether they have dialogues with the companies that are the object of their voting recommendations and the number of staff involved in the preparation of the voting recommendations.

The amended Directive would also require member states to ensure that proxy advisory firms identify and disclose without undue delay to their clients and the company concerned any actual or perceived conflict of interest or business relationships that *may* influence the preparation of the voting recommendations and the actions they have undertaken to eliminate or mitigate the actual or potential conflict of interest.

It is not yet known whether the amendments to the Shareholder Rights Directive will be adopted, or adopted in substantially the same form as set out in the European Commission's proposal earlier this year. The European Parliament and the Council of the European Union are considering the EU Commission's proposal and, if approved in some form, each member state will be required to implement the proposal within 18 months.

The Majority Voting Standard

With the implementation of rule changes by the TSX in 2012 and again in 2013, majority voting for directors of public companies is now required in Canada. As reported in 2013, majority voting replaces the historical practice of electing a director on a plurality basis when in an uncontested election a director could be elected even if more shares are "withheld" against than voted "for" the nominee. Under the current regime, issuers must now hold a shareholder vote on the election of each individual director and disclose the results of that vote, and each director is required to get more "for" votes than "withhold" votes with respect to the candidate's election.

Majority voting for directors of TSX and other non-venture issuers is now required in Canada.

Since the 2013 amendments to the TSX rules came into effect on June 30, 2014, not only must each director be elected by a majority (*i.e.*, 50% plus one vote) of the votes cast, but TSX-listed issuers must (subject to certain exceptions) have a majority voting policy and that policy must require a director who fails to get the requisite percentage of votes to immediately tender her or his resignation, and the board of directors must accept the resignation absent "exceptional circumstances". Such requirements are now in place for all TSX-listed and other non-venture issuers, subject to limited exceptions for "majority controlled" issuers.

03
Shareholder Voting Issues

DIRECTOR ELECTION AND MAJORITY VOTING TRENDS IN 2014

While the prevalence of majority voting in Canada is not a recent phenomenon, 100% of all issuers on the Composite and SmallCap Indices, as well as 100% of TSX 60 issuers, now hold individual director elections. This compares with 2013, when some but not all of the TSX amendments were in place, at which time 99% of issuers on the Composite and SmallCap Indices (100% of TSX 60 issuers) held individual director voting. Similarly, in light of TSX requirements in this area, 100% of TSX 60 issuers report the results of their director elections, as do 93.9% of Completion Index issuers and 83.8% of SmallCap Index issuers.

According to these results, some of the relatively smaller TSX-listed issuers still appear to fall short of their disclosure obligations or, in some cases, the issuers' 2014 meetings were held prior to the effective date of the 2013 TSX rule amendments; however, overall, individual director voting and the reporting thereon have become the norm with most issuers complying with the TSX rules and governance standards. Having regard to all companies on the Composite and SmallCap Indices, on average 95% of such issuers hold individual director voting and publicly report the results thereof, as compared with only 84.4% of such companies in 2013.

In 2014, 100% of TSX 60, Composite and SmallCap indices issuers held individual director elections, and the overwhelming majority disclosed the results.

More importantly, and consistent with the trend we observed in 2013, it remains extremely rare for a majority of votes to be withheld from an individual director. Of the 326 Composite Index and SmallCap Index issuers who reported their voting results for individual director elections in 2014, the average percentage of votes withheld from an individual was 3.5%, which is lower than the average percentage of withheld votes in 2013 and prior years.

Similarly, for those issuers that reported the voting results for director elections, about 90% of the directors received more than 90% of the votes cast "for" them, again up from 86% in 2013. The breakdown by TSX Index, for those issuers that reported the voting results for director elections, was as follows:

- **TSX 60:** As in 2013, all directors received 69.9% or more votes cast "for" them (with no directors receiving less than 51% approval); and just over 96% (up from 89.5% in 2013) received 91% or more votes cast in their favour.
- **Completion Index:** As in 2013, all but two directors received 51% or more votes cast "for" them, and about 90% (up from 85% in 2013) received 91% or more votes cast in their favour.
- **SmallCap Index:** All but one director received 51% or more votes cast "for" them and about 82% (up from 79.8% in 2013) received 91% or more votes cast in their favour.

On the basis of the trends observed in both 2013 and 2014, we have not yet witnessed any discernible pattern of shareholders withholding their support from management's board nominees. Rather, in 2014, only two directors from issuers on the Completion Index (Centerra Gold Inc. (TSX:CG) and Quebecor Inc. (TSX:QBR.B)) and one director of an issuer on the SmallCap Index (Partners Real Estate Investment Trust (TSX:PAR.UN)) received less than a majority of votes cast in their favour.

In all three cases in which the director did not receive the requisite shareholder approval, the director remained on the board. This is consistent with our observation noted in *Governance Insights 2013*, that when directors receive more "withheld" votes than "for" votes, the director has often remained on the board, even if the issuer had a majority voting policy. This year, in the case of Centerra Gold Inc., one of its directors, who is also the Chair of the Board, had 53.35% of the votes withheld from his election. In response, Centerra announced that the failed vote was the result of its largest shareholder withholding votes from the Chair, the Vice-Chair and independent Lead Director of the Board. Centerra disclosed that although the company did not have a majority voting policy, the Chair sought the advice of Centerra's Nominating and Corporate Governance Committee, which unanimously determined it was in the best interests of the company for him to remain on the Board and as Chair, on the basis that the director "continues to play an integral role in the Company's on-going negotiations with the Government of the Kyrgyz Republic".

Similarly, Quebecor Inc. announced that one of its directors had 61.87% of the votes cast held against his appointment. As Quebecor did not have a majority policy in place, the company announced that the director had been duly elected under corporate law and would remain on the Board. Quebecor also disclosed that the abstention rate received by that director was the result of instructions given by a proxy adviser to its clients to show their disapproval by abstaining from voting for all members of the company's Compensation Committee, particularly due to the company not holding a say on pay vote and, therefore, "this abstention rate cannot be interpreted as a value judgment on the candidate's skill".

In 2014, three directors who had failed votes remained on the board of directors, even where a majority voting policy was in place.

In the case of Partners Real Estate Investment Trust (Partners REIT), one of its directors did not receive majority approval at the 2014 meeting and, since Partners REIT did have a majority voting policy in place, the director tendered his resignation to the Board of Trustees for consideration. The Board's Governance and Compensation Committee considered the resignation and ultimately recommended to the Board, and the Board determined, to reject his resignation. Partners REIT disclosed that the Board and Committee had considered all relevant factors, "including Mr. Charlebois' significant past contributions to the Board, his valuable independent real estate expertise and the integral role he is playing in stewarding the ongoing strategic review process" and determined to retain the director.

The foregoing trends in 2014 are consistent with our predictions in 2013, and we expect will continue to foster debate about when a director subject to a failed vote should (if ever) be permitted to remain on the board. These issues are discussed further below.

MAJORITY VOTING POLICIES AND PREVALENCE

Under the TSX rules, a majority voting policy must provide for the following, among other things:

- any director must immediately tender his or her resignation to the board if she is not elected by at least a majority (50% + 1 vote) of the votes cast;
- the board must determine whether or not to accept the resignation within 90 days after the date of the relevant shareholders' meeting and must accept the resignation absent exceptional circumstances; and
- the issuer must promptly issue a news release with the board's decision, a copy of which must be provided to TSX. If the board determines not to accept a resignation, the news release must fully state the reasons for that decision.

Issuers that are "majority controlled" are exempt from the TSX's majority voting requirement. An issuer is majority controlled if a securityholder, directly or indirectly, has beneficial ownership of voting securities carrying 50% or more of the voting rights for the election of directors as of the record date for the meeting. However, such issuers must still disclose annually that they are exempt from the majority voting requirement and provide reasons for not adopting majority voting.

While many issuers had already adopted majority voting prior to the TSX amendments, in 2014, 95% of TSX 60 issuers had a majority voting policy in place, up from 91% in 2011 but down from 97% in 2013. In this regard, the only TSX 60 companies without a majority voting policy in place were Catamaran Corporation, CGI Group Inc. and Power Corporation of Canada, as discussed further below. For the Completion Index, the number of issuers with majority voting rose to 90.6% in 2014, up from 87% in 2013, and the number of SmallCap Index issuers with majority voting rose to 91.2% in 2014, up from 85% in 2013.

CGI Group Inc. had not adopted majority voting for its 2014 shareholders meeting, citing in its 2014 proxy circular "the inherent limitations of majority voting policies" and the Board's determination, on the advice of its Governance

Committee, not to institute such a policy at that time.[15] Although the CGI circular did not expressly say that the company would institute such a policy in future years to comply with the TSX rules, the absence of such a policy in 2014 is likely due to the fact that the 2013 TSX amendments were not yet effective at the time of CGI's disclosure or meeting. In the case of Catamaran Corporation, the company explained in its 2014 proxy circular that it would comply with the TSX rules in respect of its 2015 meeting.[16] Power Corporation of Canada disclosed in its 2014 proxy circular that it was relying on the "majority controlled" corporation exemption.[17]

NEXT STEPS AND FUTURE DEVELOPMENTS

With majority voting now firmly entrenched in Canada, the debate over the soundness of the practice is largely moot. However, there remains scope for further developments in this area, both due to commentary requested by Industry Canada in 2014 in respect of proposed amendments to the CBCA, including relating to majority voting (as discussed further below under "CBCA Consultation"), and more significantly, due to continued concerns about the exception, now enshrined in the TSX rules, that permit boards not to accept the resignation of a director who fails to get more than 50% of votes in "exceptional circumstances".

Many institutional investors, shareholder advisory firms and governance watchdogs are actively pushing boards to accept directors' resignations in cases in which a majority of votes are withheld, with some suggesting that there are no or very few exceptional circumstances that should entitle a board to reject such a resignation. For example, notwithstanding the TSX rule changes mandating majority voting, some are advocating for changes to the corporate statutes to require majority voting. Many are also urging corporate and securities law regulators to more clearly define what constitutes "exceptional circumstances" when a resignation may be rejected by a board. Along this line of thinking, if majority voting is to be truly effective in achieving the desired results and be binding upon boards, consistent with the position of CCGG and other advocacy groups, the only exceptional circumstances entitling a board to reject a director's resignation should be when the resignation(s) would result in a failed board rendering it unable to conduct business, such as when an insufficient number of directors would remain to satisfy the applicable independence or quorum requirements. Others consider that other rare cases might be suitable

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15 CGI Group Inc. Management Proxy Circular dated December 13, 2013 for the Annual General Meeting of Shareholders held on January 29, 2014, p. 41.

16 Catamaran Corporation Proxy Circular and Proxy Statement dated April 1, 2014 for the Annual and Special Meeting of Shareholders held on May 13, 2014, p. 5.

17 Power Corporation of Canada Management Proxy Circular dated March 19, 2014 for the Annual Meeting of Shareholders held on May 15, 2014, p. 46.

to permit a board to reject a resignation, such as when the retention of one or more rejected directors for a limited period of time may be required in order for the board to discharge its duties or to find a suitable replacement.

On the other side of the debate, some participants view the potential risks of failed boards and failed elections as a key reason against regulators' more strictly or narrowly prescribing what those exceptional circumstances may be, at the risk that issuers may find themselves unable to carry on business if a board is forced to the accept the resignation of a director who fails to receive majority approval. We do, however, note that there remains no evidence of majority voting actually resulting in a failed board in Canada or the United States rendering a board unable to discharge its duties, and certainly there are more specific rules that could be crafted, if desirable, to ensure that boards are not confronted with such realities.

Debate will continue about the "exceptional circumstances" that justify a director who does *not* receive majority approval remaining on the board.

Despite some of these urgings for further revisions, most of the TSX-listed issuers canvassed have enshrined in their majority voting policies some carve-out that would permit the board to reject the resignation of a director subject to a failed vote. Generally, the exception is crafted to enable a board to determine not to accept a resignation of such a director in "special circumstances", "extraordinary circumstances", "extenuating circumstances", "exceptional circumstances" or according to a specified list of factors. Among all TSX 60, Composite Index, Completion Index and SmallCap Index issuers, the most prevalent practice is to reference such special or exceptional circumstances, without enumerating what factors or circumstances those might be. However, we do see a minority of issuers on each of those indices starting to specify the list of factors or events that would fall within those circumstances, providing shareholders with more transparency into when they might see an undersupported director remain on the board.

On the basis of these trends, we expect that the debate on majority voting is not over, and boards will need to continue to stay abreast of developments in this area, including possible refinements to corporate and/or securities laws to more broadly mandate majority voting, the expansion of majority voting requirements to TSXV issuers (as advocated by CCGG) and greater scrutiny and guidance over what exceptional circumstances properly entitle a board to reject the resignation of a director after she fails to receive majority approval.

In addition, with the practice now the norm in Canada, we might see more shareholders flexing their muscles to withhold votes from directors as a means to express their dissatisfaction with issuers on their performance or governance practices. This is likely to be especially the case when issuers retain directors on their board even after the director has a failed vote, particularly in light of policies by proxy advising firms like ISS that will generally recommend withholding votes from individual directors if a director has received more than 50% withhold votes at a prior election and remains on the board or the company has failed to address the issues that caused the majority withhold vote.

CBCA Consultation

In December 2013, Industry Canada launched a public consultation on the CBCA in connection with its expressed desire to ensure that the governance framework for CBCA corporations remains effective, fosters competitiveness, supports investment and entrepreneurial activity, and instills investor and business confidence.[18] In the discussion paper, Industry Canada requested comments on a wide range of corporate governance matters, including the following:

- executive compensation, including whether to mandate say on pay votes;
- shareholder rights, including majority voting and individual and annual director elections;
- shareholder and board communication, including facilitating "notice and access" and the treatment of registered and beneficial shareholders in the proxy process;
- board accountability, including whether the CEO and board chair positions should be separated;
- whether to amend the residency requirements for CBCA directors;
- corporate governance, social responsibility and combating bribery and corruption;
- board and management diversity, including increasing women's representation; and
- whether to more fully recognize beneficial owners of shares by giving them rights more consistent with registered shareholders.

The CBCA consultation ended in mid-May 2014 and in response, over 75 comment letters were received. Many commentators expressed support for the efforts of Industry Canada to engage with stakeholders on a full range of governance matters and to undertake a review of, and possible amendments to, the CBCA. However, a wide divergence of views were expressed on the extensive issues raised and, in many cases, commentators expressed the view that those

18 *Consultation on the Canada Business Corporations Act*, Industry Canada available at https://www.ic.gc.ca/eic/site/cilp-pdci.nsf/vwapj/CBCA_Consultation.pdf/$file/CBCA_Consultation.pdf.

issues are better addressed by stock exchange and securities law requirements than by corporate statutes.

Perhaps the most interesting issues raised in the discussion paper from a corporate governance perspective are the issues of "empty voting" and "overvoting". As discussed above, empty voting occurs when a shareholder has disposed of his or her economic interest, through a hedge or other financial transaction, but retains the right to vote; overvoting refers to the situation in which voting rights attached to a share may be exercised more than once. As noted by Industry Canada in its discussion paper, empty voting in particular has been criticized on the basis that it may compromise the principles of shareholder democracy because an empty-voting shareholder is insulated from a decline in the value of the corporation's shares or can benefit from a lower price, and therefore the empty votes may be exercised in a way that is contrary to the interests of the corporation and of other shareholders. As for overvoting, we believe that Industry Canada (and Canadian securities regulators) should at least study whether empty voting subverts the goals of shareholder democracy and, if so, consider appropriate rule changes that would curtail or regulate the practice.

It will be interesting to see if Industry Canada joins the ongoing debate on the proxy voting infrastructure being led by Canadian securities regulators with a view to implementing amendments to the CBCA in order to resolve some of the deficiencies in how the CBCA distinguishes between registered and beneficial owners and how corporations communicate with and receive votes from beneficial owners.

It is too soon to tell whether the CBCA consultation process will result in material changes to the CBCA, although we expect that such process will not be a swift one. Once Industry Canada has had the opportunity to review the comments it received, we expect that it will provide further information concerning the next steps to be taken.

04 Hot Topics in Proxy Contests and Shareholder Activism

04 Hot Topics in Proxy Contests and Shareholder Activism

Proxy Contests in 2014

There have been 25 proxy contests involving reporting issuers in Canada as of the end of September 2014.[19] Management and incumbent boards have fared better in 2014 than in prior years, winning 12 out of the 25 proxy contests. In eight proxy contests, the dissidents achieved a complete victory through elections to the board at a shareholders' meeting. In five cases, the dissidents managed a partial victory by negotiating a settlement agreement giving the dissidents varying levels of board representation. The vast majority of proxy contests this year (20) involved dissidents seeking board changes; in the five other cases, the dissidents instead sought to stop or change an announced transaction or to effect a strategic change. After a busy first half, 2014 has not seen quite the growth in proxy contest activity that some observers were predicting.

We expect that there are several reasons for the relatively lower number of proxy contests in 2014 compared with the past several years. Perhaps most significantly, the Canadian capital markets have been stronger this year in several industries, evidenced in part by the increased number of M&A transactions involving Canadian issuers in 2014. In our view, proxy contests tend to be more prevalent during periods when M&A activity is depressed in an effort to generate superior returns through changes in corporate governance or spinoffs of non-core assets – issues often at the heart of proxy campaigns. Moreover, boards are showing a growing willingness to engage with activists privately and to implement recommended changes where a convincing case is made by the activist, without the dispute ever developing into a formal proxy contest and entering the public arena.

In addition, with the past several years' wave of activism, issuers may be becoming more proactive in addressing perceived problems in their governance or performance, in an effort to ward off the threat of such concerns developing into a costly and risky proxy contest. We have also witnessed issuers implementing defensive measures to protect themselves against activist campaigns, such as in the form of advance notice by-laws and, less commonly, enhanced quorum by-laws and "voting pills".

Proxy contests have occurred across a broad range of industries, but the mining and resources sector is clearly seeing the most activity, with nine out of the 25 proxy contests involving mining issuers, and three involving oil and gas companies. Three proxy contests to date in 2014 involved large-cap issuers (Sherritt International Corporation, Martinrea International Inc. and Osisko Mining Corporation) with market capitalizations of over $1 billion. Set out below

19 Certain information relating to proxy contests set out in this section was compiled with the benefit of data provided by Kingsdale Shareholder Services Inc.

are brief summaries of some of the material features of the contests involving these three issuers.

SHERRITT INTERNATIONAL CORPORATION

Sherritt International Corporation is a large-cap Toronto-based resource company with extensive operations across Cuba and a market capitalization of approximately $1.3 billion. On January 9, 2014, Clarke Inc., through its CEO George Armoyan, announced that it held 5% of Sherritt's shares. Clarke Inc. sought board representation and the implementation of a number of governance and compensation changes at Sherritt. The Sherritt board adopted the governance and compensation recommendations, but declined to give Clarke Inc. board representation. In response, Clarke Inc. requisitioned a shareholders' meeting, which was held concurrently with Sherritt's annual general meeting, and filed a dissident circular proposing three candidates to Sherritt's nine-member board. The main allegation in Clarke Inc.'s dissident circular was that management was enriching itself, including through controversial Helms-Burton compensation awards, while failing to create shareholder value. In April, both ISS and Glass Lewis recommended that their clients vote in favour of all management nominees. At Sherritt's annual shareholders' meeting held on May 6, all three of Clarke Inc.'s nominees were defeated and the entire incumbent slate was re-elected.

MARTINREA INTERNATIONAL INC.

Martinrea International Inc., listed on the TSX and with a market capitalization of approximately $1 billion, is the third largest auto parts manufacturer in Canada. In 2012, Nat Rea, the company's founder, stepped down from his roles in the company and, in 2013, commenced a lawsuit against the current board alleging breach of their fiduciary duties. In 2014, Rea Holdings Inc., a holding company owned by Mr. Rea, publicly disclosed its intention to run a slate of five nominees, including Mr. Rea, for election to Martinrea's seven-member board at the 2014 annual shareholders' meeting. The chief argument made by the dissidents was that the non-core assets of the company should be sold to pay down debt. Just before the annual shareholders' meeting scheduled for June 19, Rea Holdings withdrew its slate of dissident nominees, citing the desire to first resolve outstanding issues. All seven incumbent nominees were subsequently elected at Martinrea's shareholders' meeting.

OSISKO MINING CORPORATION

In January 2014, Goldcorp Inc. launched an unsolicited take-over bid for Osisko Mining Corporation (a Montreal-based gold company listed on the TSX with a market capitalization of approximately $3.3 billion at the time). In connection with the bid, Goldcorp announced its intention to launch a proxy contest to replace the entire 11-member board of Osisko with its own nominees. Subsequent to the launch of the Goldcorp bid and various extensions and amendments to its bid, Osisko announced a negotiated transaction pursuant to which it had agreed to be jointly acquired by Agnico Eagle Mines Ltd. and Yamana Gold Inc. by way of plan of arrangement. In the context of this friendly transaction, Goldcorp announced that it would not further amend or extend its bid for Osisko and allowed its bid to expire without taking up any shares. Goldcorp's proposal to replace the Osisko board was withdrawn as a result of the failed take-over bid.

The majority (16) of proxy contests in 2014 to date involved mid-cap issuers with market capitalizations between $50 million and $1 billion. Notable contests in this area included the following:

- FrontFour Capital Group LLC's contest (subsequently withdrawn) to replace the board of Renegade Petroleum Ltd. (TSXV oil and gas company);
- Goldmet B.V.'s failed contest to replace six of the eight directors of Monument Mining Ltd. (junior gold company);
- Joel Matlin's unsuccessful contest to appoint himself and his son as directors to the board of AlarmForce Industries Inc. (producer of home security systems);
- Liberty Street Capital's campaign (subsequently withdrawn) to replace the entire board of Banro Corporation (TSX-listed gold company);
- Sentry Investments' contest to replace six of the eight directors of Timmins Gold Corporation (TSX-listed gold company), which the parties subsequently settled resulting in one Sentry nominee on the board;
- Tocqueville Asset Management, LP/Tocqueville Gold Fund's contest (subsequently withdrawn) to replace three of the seven directors of Scorpio Mining Corporation (TSX-listed silver company);
- VETRA Holding S.a.r.l.'s unsuccessful campaign to prevent a proposed friendly acquisition of Suroco Energy Inc. (oil and gas exploration company);
- Quantum Pacific Investment Limited and Fides Capital Partners Limited's successful campaign to replace a portion of the board of Intrepid Mines Limited (previous metals exploration company) with its own nominees; and
- Orange Capital, LLC's contest (subsequently withdrawn) to replace the entire five-member board of Partners Real Estate Investment Trust in the context of a mini-tender offer (also discussed below under "Advance Notice Policies, Enhanced Quorum By-Laws and 'Voting Pills'").

Of the 16 mid-cap issuer proxy contests, in 12 cases the dissidents sought board change. Some exceptions were certain the Saskatchewan farmers' failed contest to oppose a plan of arrangement involving Weyburn Inland Terminal Ltd.; VETRA Holding S.a.r.l.'s unsuccessful campaign to oppose the friendly acquisition of Suroco Energy Inc.; and Access Holdings Management Company LLC's campaign to oppose the proposed (and subsequently terminated) management buyout of Tuckamore Capital Management Inc. Among the mid-cap issuer proxy contests involving campaigns for board change, the activists were unsuccessful in six cases, and succeeded in having one or more of their nominees appointed to the board in the other six, in many cases as a result of a settlement being reached between the issuer and the dissident. These included the following:

- the settlement reached between activist Orange Capital, LLC and InnVest Real Estate Investment Trust (specializing in hotel chain operations), resulting in the appointment of a combination of dissident and incumbent nominees to the InnVest board;
- George Haywood's campaign to enhance shareholder value at Neptune Technologies & Bioressources Inc. (biotechnology company), with negotiations between the parties resulting in the resignation of Neptune's CEO and CFO and the appointment of two incumbent and five new directors to the Neptune board; and
- Sentry Investments' contest to replace six directors on the eight-member board of Timmins Gold Corporation, resulting in a settlement to have seven management nominees and one Sentry nominee elected to the Timmins board.

Lastly, six of the proxy contests in 2014 to date involved small-cap issuers with market capitalizations under $50 million, including HanFeng Evergreen Inc., Mediterranean Resources Ltd., Med BioGene Inc., CRC Royalty Corporation, Process Capital Corp. and American Cumo Mining Corp. Five of these contests were won by the dissidents, and one (American Cumo Mining Corp.) was won by management.

Is a Press Release a "Solicitation"? *Smoothwater v Equity Financial* Case Study

The case of *Smoothwater Capital Partners LP I v Equity Financial Holdings Inc.*[20] occurred in connection with a proxy contest by Smoothwater Capital Partners

20 2014 ONSC 324.

LP (Smoothwater) to replace a majority of the board of Equity Financial Holdings Inc. (Equity). The decision of the Ontario Superior Court of Justice in January 2014 considered the question of what constitutes a "solicitation" under Canadian corporate and securities laws. An important finding of the case is that a press release issued by Equity during the contest, in response to the dissident's public campaign and without filing a management proxy circular, was not a solicitation.

By way of background, under corporate and securities laws, such as the CBCA and National Instrument 51-102 *Continuous Disclosure Obligations*, no person may solicit proxies unless shareholders are sent a management proxy circular (in case of solicitation by or on behalf of management) or a dissident proxy circular (in case of any other solicitation). While not the subject of much prior judicial consideration, this prohibition often raises concerns for both issuers and activists in the proxy contest arena, since the definition of "solicitation" is very broadly drafted under corporate and securities laws and arguably captures a host of activities and communications. Some obvious practices are captured by the definition, such as requesting a proxy, requesting the signing or not signing of a proxy, or sending a proxy to a shareholder. However, solicitations encompass much more, including "the sending of a form of proxy *or other communication to a shareholder under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy*". It is this latter language that may capture and perhaps prohibit many customary practices by issuers and dissidents in a proxy campaign.

There are some important exceptions to the prohibition on solicitations available to dissidents, *but not to management*, allowing activists to solicit proxies by methods other than mailing a proxy circular. One such important exception used by activists on several occasions during the past few years is a solicitation conveyed by public broadcast, speech or publication. This "public broadcast" exception was relied on by Smoothwater in its proxy campaign involving Equity, allowing it to communicate with and solicit the support of Equity's shareholders and launch a public campaign critiquing Equity's governance and performance, all without having to file a dissident circular. It has been argued that such exceptions, not available to management, provide dissidents with greater latitude to solicit proxies and can place management at a disadvantage when confronted with a proxy contest, potentially preventing the issuer from publicly responding to claims or demands by dissidents or engaging with their investors until they are to prepare and mail a proxy circular.

In this case, in reliance on the public broadcast exemption, Smoothwater initiated a proxy contest in November 2013 by issuing a press release disclosing its intention to take action to enhance the value of Equity. Smoothwater then delivered a requisition to Equity requesting that Equity call a shareholders' meeting by January 14, 2014 to reduce the board from seven to five members and to reconstitute the board with three Smoothwater nominees and two incumbents. In response, Equity issued press releases on November 18, advising that it established a special committee and engaged advisers, and on December 5, setting the date of its annual and special meeting for March 28, 2014.

On December 5, 2013, Smoothwater issued a press release criticizing Equity's delay in scheduling the meeting and outlining its concerns with the current leadership of Equity. On December 10, Equity responded with a press release that became the central issue in the case. In the press release, in response to the allegations levelled by Smoothwater, Equity defended the historical actions of the board and criticized Smoothwater for initiating a costly and unnecessary proxy contest without meaningful conversation with Equity. It also outlined Equity's concerns with Smoothwater's nominees and their lack of experience and track record of success. The end of the press release also stated that Equity would continue to engage with shareholders and would distribute a proxy circular. On the basis of the language of Equity's December 10 press release, Smoothwater filed an application with the Court alleging that Equity's press release was improper because (using the language of the CBCA) it was a communication "calculated to result in the procurement, withholding or revocation of a proxy" without Equity having filed a proxy circular. On that basis, Smoothwater sought an order directing Equity to comply with, and be restrained from breaching, the solicitation provisions of the CBCA.

During the hearing, Smoothwater argued that the December 10 press release was clearly calculated to result in the procurement or withholding of proxies, and therefore a clear solicitation. In turn, Equity argued that the press release was not a solicitation, but rather was disclosure intended to address inaccurate statements made by Smoothwater in its own press releases, and an attempt to keep Equity shareholders informed at a critical time.

The Court held that "solicitation" is to be interpreted broadly and in an inclusive manner and that it is a question of fact depending on the nature of the communication and the circumstances of transmission. However, the mere fact that Smoothwater commenced a solicitation process did not mean that Equity's responses also constituted a solicitation. The Court noted that it is inevitable that during a proxy fight anything said by Equity could be characterized as a solicitation, but the principal purpose of the document must be considered. On the basis of the facts, the Court determined that Equity's press release and the circumstances surrounding its transmission did not constitute a solicitation. The Court found that, in the context, the press release merely defended Equity's history and leadership, and explained why it fixed the meeting date when it did. Further, the Court found that the press release did not encourage shareholders to provide Equity with proxies, but rather advised that a proxy circular would be provided in advance of the meeting, and stopped short of requesting proxies.

A critical factor that likely contributed to Equity's success in this case is that Smoothwater complained about only one press release. Equity issued only one additional press release after its December 10 press release and before the Court hearing, announcing that it had rejected certain proposals made by Smoothwater, was engaged in a process, would continue to engage with shareholders and would issue a proxy circular in due course. The outcome may have been different if Equity had embarked on a public communication and shareholder engagement campaign prior to filing its proxy circular. Given the scope for public persuasion available to Smoothwater and other dissidents in reliance on the public broadcast exemption and the broad definition of solicitation, it may be that the Court's decision was influenced by a desire to avoid handcuffing issuers from responding to public criticisms levelled by dissidents during the interim period before issuers are able to file a proxy circular. However, what constitutes a solicitation remains very fact-specific. Given the concept's potentially broad scope, boards and management should be cautious with their solicitation efforts in the absence of a proxy circular.

Update on Compensation Arrangements for Director Nominees

In 2013 and 2014, high-profile proxy contests brought into focus compensation arrangements for dissident nominee directors, which prompted divergent responses from governance commentators, on the one hand, and ISS, on the other. When used, these arrangements typically provide for some combination of cash payments and/or other incentives based on some measure of company performance, as well as indemnity arrangements, in order to compensate dissident nominees in a proxy contest.

Activists have argued that such incentive payments are good corporate governance, because they help link director pay to performance, which can benefit all shareholders. Activists also argue that these arrangements are necessary to attract better candidates, who would otherwise have no compensation for their significant efforts unless ultimately elected to a board. On the other side, perhaps the most vocal critic of such arrangements is U.S. law firm Wachtell, Lipton, Rosen & Katz (Wachtell) – often noted for its work defending companies against activists. Wachtell has labelled director compensation arrangements "golden leashes" leading to "poisonous conflicts" that create a subclass of directors, compromise the nominees' independence and create dysfunctional boardrooms.

The U.S. Council of Institutional Investors (CII) has criticized such third-party incentive arrangements on the basis that they "blatantly contradict" CII policies on director compensation. Rather than promoting their outright prohibition, CII has encouraged the SEC to consider rule changes that would require dissident disclosure to investors about such arrangements, on the basis that existing rules likely fall short of such requirements.

In 2014, a debate erupted over the use of corporate by-laws to prohibit compensation arrangements between activists and their director nominees. The typical by-law, first proposed by Wachtell in 2013 and since adopted by several U.S. companies, provides the following:

> No person shall qualify for service as a director of the Corporation if he or she is party to any compensatory, payment or other financial agreement, arrangement or understanding with any person or entity other than the Corporation, or has received any such compensation or other payment from any person or entity other than the Corporation, in each case in connection with the candidacy or service as a director of the Corporation.

While the by-law formulation proposed by Wachtell and supported by others typically includes exceptions for indemnification agreements and reimbursement of out-of-pocket expenses in connection with candidacy or service as a director, its essential purpose is to make any nominee that otherwise receives any compensation from an activist ineligible to be proposed as a nominee for the issuer's board.

In response, ISS issued a pronouncement in early 2014 that it would consider such arrangements on a case-by-case basis, leaving the door open for this practice. In a subsequent strong statement, ISS stated that the adoption of restrictive director qualification by-laws without shareholder approval "may be considered a material failure of governance because the ability to elect directors is a fundamental shareholder right". ISS went on to say in its January 2014 FAQ that it may recommend a vote against or withheld from director nominees consistent with ISS's "Governance Failures" policy, where such by-laws are implemented by boards. In contrast, by-laws which preclude from board service those director nominees "who fail to disclose third-party compensatory payments" are acceptable to ISS on the basis that such provisions may provide greater transparency for shareholders and allow for better-informed voting decisions.

The debate over the use of such restrictive by-laws received particularly heightened attention in the proxy contest involving U.S. bank Provident Financial Holdings Inc. in late 2013. In that case, ISS opposed the re-election of three board members of the bank who, as members of the Governance Committee, approved a by-law that would prevent such investor-paid bonuses. The by-law followed the formulation recommended by Wachtell. According to ISS, the by-law amendment adopted by Provident may be concerning to investors for the following reasons:

- It prohibited individuals from board service due to any arrangements to compensate a nominee during their candidacy, with only limited exceptions.
- It could deter legitimate efforts to seek board representation via a proxy contest.
- It could have the effect of excluding highly qualified individuals from being candidates for board service, thereby serving to entrench the incumbent board.
- It was adopted after a significant shareholder made Schedule 13D filings with the SEC disclosing the addition of affiliates to its group.
- It was adopted without giving shareholders the opportunity to vote on the matter (despite the board not having been required to submit the amendment to a shareholder vote).

Although ultimately the Provident directors were re-elected despite ISS's recommendations, the relatively low level of investor support obtained for those directors highlights the scrutiny boards may face if they opt to implement such a by-law. Despite this, according to ISS many U.S. companies followed Wachtell's advice and implemented such by-laws in 2013. ISS has left open the possibility that it could support such a restrictive by-law; however, that is only likely to be the case if the by-law is put forward to and approved by the shareholders. Even then, ISS will apply a case-by-case analytical framework, taking into consideration various factors, including the board's rationale for proposing the by-law, whether it materially impairs and/or delivers any offsetting improvements in shareholders' rights, and any market-specific practices or views on the underlying issue.

In light of the continued debate over the issues, activists seeking to implement compensation arrangements with their nominees will need to be careful about how they are crafted to allay concerns about nominee independence and ensure they are aligned with the long-term interests of shareholders. In fact, much of the concern is more focused on the actual terms of the compensation, rather than the principle of providing some compensation. Boards considering implementing restrictive director compensation by-laws should carefully consider their motivation for doing so and be prepared for significant resistance from investors and others, particularly if such by-laws are not approved by the shareholders. In fact, the better course of action may be to consider limiting such requirements to providing for disclosure on such arrangements, rather than seeking to prevent candidates from being put forward by activists for shareholder consideration.

Advance Notice Policies, Enhanced Quorum By-Laws and "Voting Pills"

In response to shareholder activism, some issuers are considering the implementation of defence mechanisms to shield against an activist shareholder. Notably, advance notice and enhanced quorum policies or by-laws and voting pills have emerged as three such tools that issuers are having recourse to, although, as discussed below, one is more prevalent than the others.

RECENT TRENDS AND DEVELOPMENTS IN ADVANCE NOTICE REQUIREMENTS

Advance notice provisions in company by-laws or as board policies, requiring a shareholder to provide advance notice to an issuer if it wishes to propose nominees to the board, have gained significant traction in Canada over the past couple of years, and particularly during 2013. If properly constructed and used, advance notice requirements can prevent a shareholder from "ambushing" an issuer by waiting until the annual shareholders' meeting to first propose nominee(s) from the floor. In 2012, courts condoned the use of such policies on the basis that they foster transparency and informed decision-making by providing shareholders with reasonable notice of, and information concerning, a contested election of directors; the courts also indicated that the use of these policies can be a reasonable measure to prevent a dissident from "hiding in the weeds" and taking advantage of low voter turnout. As a result of the support for these types of arrangements, many Canadian issuers rushed to implement such requirements in 2013.

The defence has been commonplace in the United States for several years, and is now becoming accepted practice in Canada, despite some concerns that advance notice by-laws can impose unreasonable hurdles on shareholders wishing to nominate directors and, therefore, may be inconsistent with shareholder democracy.

Although the number of issuers adopting advance notice requirements in 2014 appears relatively lower than in 2013, Canadian issuers are still clearly supporting their usage. For example, proxy solicitation firm Kingsdale Shareholder Services Inc. reports that the total number of Canadian issuers with advance notice policies has increased to almost 1,200;[21] while a majority of those

21 Kingsdale Shareholder Services Inc., *2014 Proxy Season Review* (September 2014) available by contacting Kingsdale at http://www.kingsdaleshareholder.com.

are Canadian issuers listed on the TSXV, almost 100 Composite Index issuers (approximately 40%) have also adopted such policies. Our study similarly reveals that, as of September 2014, over 40% of issuers on the Composite Index and SmallCap Index have adopted advance notice requirements and, among those, 18.5% put an advance notice policy forward at their 2014 shareholders' meeting as an item of business. Among these issuers, 15.9% were listed on the TSX 60.

NEW ISS CONSIDERATIONS FOR ADVANCE NOTICE POLICIES

In their 2014 proxy advisory guidelines, both ISS and Glass Lewis advise that they will recommend that shareholders vote to ratify the adoption of reasonable advance notice policies. ISS and Glass Lewis indicate that to be reasonable, the issuer's deadline for requiring notice must not be more than 65 days and not fewer than 30 days before the meeting date.

ISS and Glass Lewis also updated their proxy voting guidelines in 2014 to include a number of new recommendations relating to advance notice requirements. ISS will now recommend voting against advance notice by-laws if the board may only waive a portion of the advance notice provisions in its sole discretion. It believes that advance notice requirements designed to limit a board's ability to waive all provisions of the policy may potentially be used by the board to deny shareholder nominee access to the board and prevent the possibility of shareholder recourse through the courts. ISS will also recommend voting against advance notice by-laws if the company requires any proposed nominee to deliver a written agreement wherein the proposed nominee must acknowledge and agree that he or she will comply with all policies and guidelines of the company that are applicable to directors. ISS believes these requirements raise concerns in situations in which board policies or guidelines are considered unacceptable from a governance perspective, or may prevent new board candidates from effecting change support by the issuer's investors.

ADVANCE NOTICE CASE STUDY: *ORANGE CAPITAL, LLC V PARTNERS REIT*

Another development in advance notice requirements came in the summer of 2014 from the Ontario Superior Court's reaffirming the proper purpose of and means of applying such requirements in the context of a battle for control of Partners Real Estate Investment Trust (Partners REIT).[22] Ultimately, the Court held that an advance notice policy should be given a plain and purposive interpretation and any ambiguity should be resolved with a view to preserving unitholder rights.

22 2014 ONSC 3793.

On April 21, 2014, Partners REIT filed notice of its 2014 annual and special meeting scheduled to be held on June 26. Under the terms of Partners REIT's existing advance notice policy, which was consistent with policies adopted by other Canadian issuers as discussed in *Governance Insights 2013*, nominations for trustees were required to be made "not less than 30 nor more than 65 days prior to the date of the annual meeting of unit holders". With a June 26 meeting, notice would have to be provided between April 22 and May 27. On May 28, Orange Capital, a New York-based hedge fund, announced a "mini-tender" offer to purchase 10% of the outstanding units of Partners REIT, which was open until June 12.[23] At the time of the May 28 announcement, Orange Capital also announced its intention to nominate trustees for election at the meeting. On May 29, Partners REIT postponed the meeting to July 15, 2014. Subsequently, on June 6, Orange Capital provided formal notice to Partners REIT that it would be nominating five individuals at the meeting.

Partners REIT took the position that Orange Capital did not comply with the advance notice policy on the basis that the policy contained a provision that "[i]n no event shall any adjournment or postponement of a meeting of unit holders or the announcement thereof commence a new time period for the giving of ... notice." Partners REIT argued that the original date (*i.e.*, June 26) of the meeting was the correct date for calculating the notice period under the policy and any adjournment or postponement of that date did not affect the notice period and, accordingly, the Orange Capital notice was invalid and Orange Capital was prevented from putting forward its nominees. In response, Orange Capital took the position that the notice period was triggered by the actual meeting date (*i.e.*, July 15) and not the original date. Orange Capital

23 The offer would not have resulted in Orange Capital's ownership reaching the 20% level, and therefore it was not a takeover bid subject to Canadian takeover bid rules. Prior to the Court hearing, Partners REIT filed a complaint with the OSC alleging that Orange Capital's offer was coercive and abusive to the capital markets, because (i) a depositing unitholder was required to appoint Orange Capital as its nominee and proxy in respect of all units deposited, even if the units were not taken up; (ii) the offer did not specify when deposited units would be taken up and paid for, and Orange Capital could, in its sole discretion and even if all conditions of the offer were met, vary, extend or withdraw the offer; (iii) a withdrawal of the offer by Orange Capital, or a withdrawal of units deposited by a unitholder, did not affect the irrevocable proxies required to be delivered under the offer; (iv) the timeframe of the offer was short; and (v) the offer did not comply with Canadian proxy solicitation laws since Orange Capital was in effect soliciting proxies without having filed a dissident circular. On June 9, after what Orange Capital referred to as constructive discussions with OSC staff, Orange Capital issued a press release extending and significantly modifying the offer. Orange Capital eventually withdrew its proxy solicitation and allowed the mini-tender to expire without taking up any units. The impact of the discussions with the OSC on the changes to Orange Capital's mini-tender offer and proxy solicitation is instructive and should be carefully considered by issuers and dissidents when engaged in proxy contests. Full details are contained in our July 2014 bulletin "*OSC Flexes Muscles in Proxy Contest Arena*" available at http://www.dwpv.com/en/Resources/Publications/2014/OSC-Flexes-Muscles-in-Proxy-Contest-Arena.

further argued that the provision dealing with postponements in the policy was to ensure that timely nominations did not become "stale" as a result of an adjournment or postponement, requiring the nomination process to be repeated. Orange Capital filed an application with the Ontario Superior Court challenging Partners REIT's refusal to recognize its nominees.

At the hearing, Orange Capital argued, among other things, that the trustees did not have the authority to implement the policy without unitholder approval or, in the alternative, either Orange Capital had complied with the advance notice requirements or the board of trustees of Partners REIT should waive the policy in respect of Orange Capital. The Court sided with Orange Capital, determining that it had complied with the advance notice requirements, and made the following key findings in respect of Partners REIT's advance notice policy:

- Partners REIT had ample notice of Orange Capital's proposed nominees (more than 30 days prior to the postponed meeting date).
- The provision dealing with adjournments and postponements was ambiguous and, on this basis, the plain meaning of the policy suggested that the actual "date of the annual meeting" should be used to define the notice period, and not the originally scheduled date. The Court also agreed that the adjournment/postponement provision simply stated that the nominating shareholder was not required to make a further nomination if the meeting was adjourned or postponed; that is, it was intended to protect nominating shareholders from "stale notices" by eliminating the need for a unitholder to give further notice of its nominees at a meeting in the event that the notice fell outside of the new notice period, based on the re-scheduled date.
- The Court determined that the purpose of an advance notice policy is defensive in nature and is to be used "as a shield" to protect shareholders, as well as management, from ambush from the floor of a meeting and ensure that shareholders are properly informed. It is *not* to be used "as a sword" to prevent nominations by shareholders, particularly when nominations are given on ample notice.
- Lastly, any ambiguity in an advance notice policy should be resolved in a manner that favours securityholder rights, not undermines them. In this case, the Court held the ambiguity should be resolved to reflect the more commercially reasonable interpretation, which favoured unitholder voting rights, so that the postponement language only prevented a timely nomination from becoming stale as a result of an adjournment or postponement.

The decision reaffirmed the legitimacy of advance notice policies, but cautioned issuers that they should be used to protect the interests of shareholders by providing adequate time and disclosure for shareholders to consider an activist's nominees. Such policies are *not* intended to protect issuers against having to engage with activist shareholders or their proposals.

ENHANCED QUORUM BY-LAWS

Another more novel, and less prevalent, measure employed by some issuers as a defense mechanism against proxy contests has been to amend their by-laws to create an elevated quorum threshold for contested meetings in which shareholders seek to replace a majority of the board. Although Canadian public companies typically have a quorum for shareholders' meetings of 10% or less of the outstanding shares, enhanced quorum by-laws require that in a contested election, often when a majority of the board (rather than a short slate of nominees) is at stake, there must be securityholders present in person or by proxy entitled to vote at least a majority of outstanding securities entitled to vote. If the enhanced quorum threshold is not satisfied, the meeting is typically adjourned for a period of up to 65 days.

Proxy advisory firms have come out strongly against such by-laws. ISS's 2014 proxy advisory guidelines provide that it will recommend that shareholders vote against by-laws that would result in a higher quorum for contested meetings in which investors seek to replace a majority of the current board members. ISS's view is that such by-laws are subject to management's predetermination that a contested election is the singularly most important corporate issue, and this conflicts with the principle that all matters submitted to shareholders for approval should carry equal importance and have the same quorum requirements.

"VOTING PILLS": THE NEXT GENERATION?

Recently, we have seen a handful of Canadian issuers implement poison pills triggered not only by the acquisition of voting shares but also by agreements to vote shares together. These so called "voting pills" had been relatively rare in Canada due in large part to ISS's long-standing opposition to such features, as outlined in its *2014 Canadian Proxy Voting Guidelines*.

> Despite opposition from regulators and proxy advisory firms, some issuers have implemented and obtained shareholder approval for voting pills.

A recent example in Canada is the rights plan adopted by Augusta Resource Corporation (Augusta) in response to the 2013 unsolicited bid by HudBay Minerals Inc. (HudBay). The Augusta rights plan defined "beneficial ownership" to include any securities that a shareholder has the right to vote or the right to direct the voting, whether or not immediately exercisable and whether or not on conditions or subject to a contingency. In the rights plan hearing before the B.C. Securities Commission relating to HudBay's take-over bid for Augusta, HudBay argued that the fact that Augusta's rights plan covered securities over which HudBay had a right to control voting precluded it from conducting a proxy contest and, therefore, the shareholder vote on the Augusta pill was unfair. However, the BCSC did not rule on the point. Further details about the BCSC's decision in the Augusta/HudBay hearing can be found in Chapter 5 under "British Columbia Securities Commission Decision in *HudBay Minerals Inc. v Augusta Resource Corporation*".

The CSA has emphatically condemned voting pills. In its March 14, 2013 release *Notice and Request for Comment: Proposed National Instrument 62-105 Security Holder Rights Plans*, the CSA stated:

> A Rights Plan is only effective against take-over bids as defined in securities legislation or other acquisitions of securities of the issuer and does not apply to transactions or circumstances involving a shareholder vote such as contested director elections. The ability of shareholders to vote their shares or make proposals should not be affected by the operation of a Rights Plan.

Notwithstanding this view and ISS's position on voting pills, the fact remains that some Canadian issuers have implemented such pills and have obtained shareholder approval for them. We have also witnessed instances in the United States in which issuers have included in their rights plans expanded definitions of "beneficial ownership" and "acting jointly or in concert" or have included lower (*i.e.*, 10%) triggering thresholds for activist shareholders (rather than passive investors) in an effort to expand the application of such plans to agreements (written or not) among investors to vote together or campaign to change or influence the control of an issuer. To date, U.S. courts have left open the possibility of boards using rights plans as a defensive measure in response to threats against an issuer's corporate policies, provided that, among other things, such plans are targeted at a legitimate threat (and not an improper purpose, like entrenchment) and the board's decision to implement the plan is reasonable in the circumstances.[24] We expect that this issue will be in the spotlight in the coming year.

Update on Beneficial Ownership Reporting: Early Warning Threshold Will Remain at 10%

In an update issued on October 10, 2014, the CSA announced that it will *not* be lowering Canada's early warning reporting threshold from 10% ownership to 5% as previously proposed. The CSA had proposed lowering the threshold as part

24 *Third Point LLC v William F. Ruprecht and Sotheby's*, C.A. No. 9469-VCP (Del. Ch. May 2, 2014).

of a suite of amendments to Canada's early warning regime that were proposed in March 2013. See Davies' March 2013 bulletin *CSA Proposes Changes to Early Warning Requirements*[25] on the originally proposed amendments. In addition to keeping the reporting threshold at 10%, the CSA has decided not to proceed with the proposal to include "equity equivalent derivatives" (such as total return swaps) in determining whether a shareholder has crossed the threshold for early warning reporting disclosure.

We expect the CSA's announcement (which was issued shortly before finalizing this report) will be enthusiastically received by many in the investment community that had broadly opposed several aspects of the originally proposed amendments, in particular the proposed 5% threshold and the inclusion of equity equivalent derivatives in threshold calculations. In contrast, Canadian issuers had supported the lower 5% threshold. Among the 70 comment letters that the CSA received in response to the 2013 proposed amendments, the Managed Funds Association (MFA) and the Alternative Investment Management Association (AIMA) submitted an extensive white paper opposing the changes.[26] Davies represented MFA and AIMA.

Recognizing that commenters had generally agreed with its objective of enhancing transparency, the CSA stated in its announcement that it will proceed with other elements of the proposed amendments that further that objective, such as the following:

- requiring disclosure of 2% decreases in ownership;
- requiring disclosure when a shareholder's ownership interest falls below the reporting threshold;
- making the alternative monthly reporting system unavailable to eligible institutional investors when there is an intention to engage in proxy solicitation (with clarification on the circumstances when they would be precluded);
- exempting lenders from disclosure requirements if they lend shares pursuant to a specified securities lending arrangement;
- exempting borrowers, in certain circumstances, from disclosure requirements if they borrow shares under a securities lending arrangement;
- providing guidance clarifying the current application of early warning reporting requirements to certain derivatives and requiring disclosure of derivatives in the early warning report;

25 http://www.dwpv.com/en/Resources/Publications/2013/CSA-Proposes-Changes-to-Early-Warning-Requirements.

26 http://www.osc.gov.on.ca/documents/en/Securities-Category6-Comments/com_20130712_62-104_kaswellsj.pdf.

- enhancing and improving the disclosure requirements in the early warning report; and
- clarifying the time frame to file the early warning report and news release.

The CSA's announcement followed a statement issued at the beginning of October 2014 by a United States Securities and Exchange Commissioner that the SEC is unlikely to tighten Rule 13d, the corresponding U.S. early warning regime, by shortening the 10-day disclosure window. Rule 13d requires non-passive investors to disclose ownership of more than 5% in public companies but, unlike the Canadian rules, allows shareholders a window of 10 days after crossing the 5% threshold to file a report. The 10-day disclosure window allows shareholders to continue purchasing shares after crossing the 5% threshold, in some cases to ownership in excess of 10%.

The CSA has stated that it intends to publish final rule amendments implementing these changes to the early warning reporting regime in the second quarter of 2015.

Shareholder Proposals

Canadian corporate law permits shareholders to propose that certain business be put on the agenda for a meeting of shareholders. The timing and substance of the proposal must satisfy statutory requirements. The business submitted by a shareholder proposal must be included in the management proxy circular for the corporation's annual general meeting. Under the CBCA, in order to be eligible to submit a shareholder proposal, a shareholder must hold, or have the support of shareholders in aggregate holding, voting shares equal to at least 1% of the outstanding voting shares or whose fair market value is at least $2,000. Typically, such shares must have been held for at least six months prior to the shareholder submitting the proposal.

The number of issuers that had shareholder proposals on their annual meeting agenda increased from 14 in 2013 to 18 in 2014.

A review of the Composite Index and the SmallCap Index shows that the number of issuers that had shareholder proposals on their annual meeting agenda increased from 14 in 2013 to 18 in 2014. All of these issuers are on the Composite Index and nine of those issuers are financial institutions, compared with seven in 2013. For the most part, shareholder proposals continue to receive very weak support from shareholders (typically less than 10%, consistent with prior years). The following is a summary of some of the most frequent proposals received during the 2014 proxy season:

- "Gender parity on the board" proposals were put to seven issuers in 2013 and only one issuer in 2014 (Metro Inc.), which received 3.18% of votes.

- The number of issuers receiving say on pay proposals increased from three in 2012 and six in 2013, to 10 in 2014. This season, the votes in favour range from 1.7%, in the case of Canadian Imperial Bank of Commerce, to 33.1%, in the case of Sherritt International Corporation. In the case of Sherritt, a say on pay proposal for directors was also put to shareholders, garnering 34.2% of votes in favour, as discussed in detail in Chapter 2 above under "Say on Pay on the Rise".
- "Greater disclosure of pension plan oversight" proposals, which refer to the board assuring shareholders and stakeholders annually that the pension plans offered are managed in accordance with sound management practices, were put to only one issuer in 2012, to nine issuers in 2013 and to four in 2014. The 2014 votes in favour range from 1.8%, in the case of Canadian Imperial Bank of Commerce, to 3.8%, in the case of The Bank of Nova Scotia.
- "Gradual phasing out of stock options as a form of compensation" proposals were put up to six issuers in 2014, with votes in favour ranging from 2.8%, in the case of Canadian Imperial Bank of Commerce, to 5.1%, in the case of Metro Inc. These proposals were all made by Le Mouvement d'education et de défense des actionnaires (MEDAC) – a Montréal-based shareholder group.
- Proposals to launch a tendering process for auditing services, were put up to four issuers, with votes in favour ranging from 0.8%, in the case of Laurentian Bank of Canada, to 8.2%, in the case of Industrial Alliance Insurance and Financial Services, Inc.
- Proposals for the issuer to disclose steps to be taken to comply with the OECD plan introduced on July 20, 2013, with respect to the failure by multinationals to pay their fair share of taxes, were put to five issuers, with votes in favour ranging from 1.3%, in the case of Canadian Imperial Bank of Commerce, to 2.5%, in the case of Royal Bank of Canada.

Less typical were the proposals made to Power Corporation of Canada, Industrial Alliance Insurance, Financial Services, Inc. and three other issuers suggesting that they disclose the steps to be taken given the high number of abstentions received by certain board members and the subsequent dissatisfaction expressed by shareholders. This proposal was approved by 8.0% of the votes in the case of Industrial Alliance, and 1.2% of the votes in the case of Power Corporation.

Examples of issuer-specific shareholder proposals include those put to Sherritt International Corporation and Talisman Energy Inc. In the case of Sherritt, one proposal was aimed at stopping the board from authorizing certain payments to directors. The proposal was narrowly defeated, receiving 49.1% of votes in favour. In the case of Talisman, a proposal requested that the company adopt a policy that in the event of a change in control, there would be no acceleration of vesting of equity awards granted to senior executives, subject to the Human Resources Committee's ability to make exceptions on a partial, pro rata basis up to the time of the senior executive's termination. The proposal was narrowly defeated, receiving 47.55% votes in favour.

Lastly, in the case of Quebecor Inc., a proposal was put to shareholders that the issuer amend its by-laws so that the Class A and B directors be elected by a majority of the votes cast by the shareholders present at the meeting in person *or by proxy*, and not, as with Quebecor's by-laws, only by the shareholders present at the meeting. This was the only shareholder proposal in 2014 that was passed, garnering 99.82% of the votes in its favour.

05

Rights Plans and Take-Over Reform

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Rights Plans and Take-Over Reform

Rights Plan Reform Proposals in 2013

The last 18 months have seen significant developments in the issues that most affect board of directors facing unsolicited take-over bids.

To recap briefly, in March 2013, the CSA, excluding Québec's Autorité des marchés financiers (AMF) published for comment a new stand-alone rule, National Instrument 62-105 *Security Holder Rights Plans* and related amendments (CSA Proposal), proposing a new regime for regulating "poison pills" in Canada. At the same time, the AMF released a consultation paper with proposals for broader changes to Canada's take-over bid and defensive tactics regimes (AMF Proposal), to provide a forum for discussion on its alternative approach to regulation that it believed should be considered as an alternative to the CSA Proposal.

CSA PROPOSAL

The CSA Proposal reflected regulators' desire to get out of the business of deciding when rights plans should go while a take-over bid is under way for a target, and would have shifted decision-making regarding maintaining rights plans to shareholders by allowing a rights plan adopted by a target board to remain in place, provided that shareholder approval is obtained within prescribed timelines.

The CSA Proposal included the following basic elements:

- To remain effective following adoption by a board, a poison pill would have had to be approved by a majority vote of the target's disinterested shareholders (i.e., excluding votes held by the bidder and its joint actors) within 90 days of the board's decision or the commencement of a bid, whichever is earlier. Otherwise, the plan would automatically lapse after 90 days.
- Material changes to an existing rights plan would have had to be approved within 90 days of the adoption of such changes in order for the amendment to remain effective.
- If a target failed to obtain shareholder approval of the plan within the prescribed time limits, the issuer could not adopt a new rights plan for 12 months, unless a take-over bid were commenced for the target within that 12-month period.

- Once the plan was approved by shareholders, a target's board would have had to seek shareholder approval annually at the target's annual shareholders' meeting in order for the plan to remain effective.
- Shareholders could terminate a rights plan at any time by majority vote.
- A rights plan could be effective only against take-over bids or a person's acquisition of securities of the issuer. As a result, it could not be used to affect the ability of shareholders to vote their shares, make proposals or enter into irrevocable lock-up arrangements with bidders.

The main effect of the CSA Proposal was that a target company would have been able to forestall an unsolicited bid for at least 90 days through the adoption of tactical rights plans. In addition, under the CSA Proposal, if the target had a shareholder-approved rights plan in place or adopted a tactical plan in the face of a bid and immediately sought and obtained shareholder approval, a plan could potentially have remained intact for a year before having to be reapproved by shareholders.

AMF PROPOSAL

In contrast to the CSA Proposal, the AMF's Proposal would have replaced existing National Policy 62-202 *Take-Over Bids – Defensive Tactics* (NP 62-202), which governs all defensive tactics, with a new policy that would have given target boards far more discretion and deference in the exercise of their fiduciary duties to respond to an unsolicited offer. The view articulated by the AMF was that regulators should regard defensive tactics as not being prejudicial to the public interest per se and therefore regulatory intervention should be limited to public interest grounds, such as an abuse of shareholder rights, a negative impact on the efficiency of capital markets or mismanagement of a target board or management's conflicts of interest in the change of control context. The AMF's proposed new defensive tactics policy would have focused more on the process followed by a target board. Under the AMF Proposal, in assessing the reasonableness of a target board's defensive tactics, the regulators would consider the following factors, among others:

- the establishment of a special committee of independent directors to consider and review the bid and make a recommendation to the board;
- the appointment of independent financial and legal advisers to assist the special committee in carrying out its mandate;
- the conclusion of the special committee and the board that, on the basis of their review of the bid and advice of legal and financial advisers, it was in the best interests of the target to implement a defensive measure; and

- the completeness of the disclosure provided to shareholders in the directors' circular, and other communications used by the target, on the process followed in order to make their recommendation and their reasons in support of the defensive measure.

If, based on the above, appropriate safeguard measures were implemented and monitored by the boards and their advisers, the AMF believed there would be reasonable assurance that directors' decisions were not tainted by conflicts of interest, and therefore regulators would be able to defer to the decisions of boards. Regulators' involvement would therefore be limited to examining the context in which the bid takes place and the processes followed by the target board on public interest grounds, and presumably result in far less regulatory intervention.

The CSA and AMF received many comment letters on their proposals and for many commentators, there were pros and cons associated with each alternative.

Most commentators were supportive of initiatives to resolve the differing approaches that have been taken by the provincial securities commissions regarding rights plans, creating an unequal and uncertain take-over bid regime across Canada.

Some commentators noted that the CSA Proposal relied heavily on shareholder approval to determine the proper scope and duration of rights plans, bringing a heightened focus on the challenges that exist with the quality of shareholder voting in Canada. As we highlighted in *The Quality of the Shareholder Vote in Canada*,[27] our 2010 paper assessing the Canadian shareholder voting process, there are a number of problems with the proxy voting system that are acknowledged to compromise (or have the potential to compromise) the quality of shareholder voting in Canada, including not counting all votes; double voting; and empty voting through the use of derivatives, hedges and other techniques. Some of these problems are discussed in Chapter 3 under "Proxy Voting Reform Initiative and Developments".

Accordingly, for some, the CSA Proposal's focus on a shareholder primacy approach underscored the need for regulators to prioritize and move forward with improvements to the proxy voting system and regulatory framework.

Other commentators favoured the AMF approach, in light of the deference it gives to boards to carry out their fiduciary duties, particularly in light of a board's overall responsibility for managing a company's business and affairs, having regard to the company's best interests. However, a possible result of the AMF's proposal might have been a significant increase in proxy contests following take-over bids, making bids more costly and time-consuming.

27 http://www.dwpv.com/en/Resources/Publications/2010/Flash-Release-of-Discussion-Paper-The-Quality-of-the-Shareholder-Vote-in-Canada.

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Rights Plans and Take-Over Reform

BRITISH COLUMBIA SECURITIES COMMISSION DECISION IN *HUDBAY MINERALS INC. V AUGUSTA RESOURCE CORPORATION*

Against this background, the decision of the British Columbia Securities Commission (BCSC) in HudBay Minerals Inc. (HudBay) and Augusta Resource Corporation (Augusta) in May 2014 was highly anticipated and is the most significant regulatory decision on rights plans of 2014.[28]

The central issue put to the BCSC was whether to respect the overwhelming vote of the shareholders of Augusta in the face of the hostile bid by HudBay to continue the Augusta rights plan until the Augusta annual general meeting in 2015. At a shareholders' meeting held on May 2, 2014, which occurred while the BCSC hearing was taking place though temporarily adjourned, over 78% of the outstanding shares of Augusta were voted on the rights plan resolution. Excluding the shares held by HudBay, 94% of those shares were voted in favour of the continuation of the rights plan.

The BCSC Panel expressly determined not to follow completely the policy changes reflected in the CSA Proposal released in March 2013. A fundamental premise of the CSA Proposal was that shareholders, by majority vote, could continue a rights plan even if the effect of doing so would be to prevent those shareholders who wished to sell their shares to the hostile bidder from doing so. In that sense the CSA Proposal represented a reversal of the approach that underlies many of the Canadian rights plan decisions, which have treated the right of each individual shareholder to decide whether to accept or reject a hostile bid as a bedrock principle of Canadian securities regulation.

In its reasons, the BCSC Panel reverted to the long line of Canadian rights plan decisions as the basis for its determination to cease-trade the Augusta rights plan, maintaining the traditional regulatory position that it is a question of when, not if, the rights plan of a target must go. The BCSC Panel examined the various factors typically cited in Canadian rights plan decisions to determine when to cease-trade the Augusta rights plan, including the likelihood that with more time the Augusta Board of Directors could find a superior transaction; whether the HudBay bid should be considered coercive in the absence of a minimum tender condition; the likelihood of HudBay extending its bid; and the weight to be attached to the overwhelming approval of the Augusta shareholders for the continuation of the rights plan for the following year. After considering these factors, the Panel determined not to cease-trade the rights plan immediately, but rather on July 15, 2014, if the HudBay bid was amended to satisfy certain issues raised by the Panel. That decision allowed the rights plan to remain in effect for 156 days following the commencement of the HudBay bid, significantly longer than the 45 to 70 days historically allowed by the Canadian securities regulators.

28 2014 BCSECCOM 154.

Interestingly, in justifying its decision to not respect the vote of the Augusta shareholders, the BCSC Panel was quite critical of the Canadian shareholder voting system and expressed serious concerns about relying upon the shareholder vote when millions of shares have traded between the record date for the meeting and the meeting itself. This raised a serious concern in the minds of the Panel members about relying on votes cast by shareholders who may no longer own shares and effectively disregarding the views of those who purchased their shares after the record date for the meeting. Those comments strike at the heart of the CSA's proposed rights plan rule: it was premised on respecting an informed shareholder vote given in the face of a hostile bid, thus foreshadowing the BCSC decision to abandon the CSA Proposal as seen in its conclusion in the September 2014 CSA announcement on take-over bid reforms discussed below.

The voting issue that the BCSC Panel members found troubling is an inherent part of the fabric of many transformational Canadian public company transactions completed through plans of arrangement, amalgamations and similar shareholder vote structures. Transactions of that nature proceed on the basis of a shareholder vote given many weeks after the record date for the applicable meeting, a period when shareholder turnover typically is substantial. Although there are clearly issues with the Canadian proxy system and the Canadian securities regulators are considering changes to improve it, as discussed in Chapter 3 under "Proxy Voting Reform Initiative and Developments", Canadian courts and securities regulators have in the past implicitly accepted the ownership/voting disparity focused on by the Panel as an intrinsic reality of public company governance. In that sense, the approach of the BCSC in the Augusta decision was somewhat novel.

Take-Over Bid Legislative Reform

Against this background, market participants anticipated that when regulatory reform came, it would likely follow the shareholder primacy approach of the March 2013 CSA Proposal and, to a limited extent, the *Augusta* decision. As a result, relatively few expected the unanimous announcement by the CSA (including the AMF) on September 11, 2014 that they would abandon the reform of rights plan regulation suggested in 2013 in the CSA and AMF Proposals and instead pursue legislative reform to mandate a 120-day period for take-over bids in Canada. The amendments are aimed at "rebalancing the current dynamics between hostile bidders and target boards", and, in effect, will give target boards more time to respond and seek alternatives to a hostile bid, making bids materially more challenging for hostile bidders than under the current Canadian take-over bid rules.

The proposed new harmonized take-over bid rules would require all formal take-over bids to have the following features:

- **Mandatory Minimum Tender Condition:** The bid must be subject to a mandatory tender condition that a minimum of more than 50% of all outstanding target securities owned or held by persons other than the bidder and its joint actors be tendered before the bidder can take up any securities under the bid; and
- **10-Day Extension:** The bidder must extend the bid for an additional 10 days after achieving the mandatory minimum tender condition and announcing its intention to take up and pay for the securities deposited under the bid.

In the CSA's view, the proposed amendments to the bid rules seek to "facilitate the ability of shareholders to make voluntary, informed and co-ordinated tender decisions and provide target boards with additional time to respond to hostile bids, each with the objective of rebalancing the current dynamics between hostile bidders and target boards."

In addition to lengthening the amount of time that a hostile bid would have to remain outstanding, the proposed amendments would essentially eliminate the ability of a bidder to acquire a small but nevertheless material percentage of shares through a bid that, even if widely accepted by target shareholders, involves the take-up of less than 50% of unaffiliated shares.

The CSA is not currently contemplating any changes to the existing defensive tactics policy (NP 62-202). Although the proposed amendments will give target boards more time to seek alternatives to a hostile bid than boards have had through using shareholder rights plans, rights plans may well continue to be relevant to regulate the ability of shareholders to accumulate large positions in a company through transactions that are exempt from the take-over bid rules, as well as potentially in other situations. It will be interesting to see whether rights plans may still be used to afford a target board even more time after the new 120-day bid period has elapsed. If so, we would expect that there will be a heavy burden on issuers to demonstrate that it is not "time for a rights plan to go" if a bidder has complied with the new rules.

The CSA intends to publish the proposed amendments to the take-over bid rules in the first quarter of 2015. Given the long period of consultation and the fact that the AMF has determined not to pursue its prior proposal, we believe the proposed amendments will become effective, but it may also become important for the CSA to carefully review all components of the take-over bid rules to ensure that no other provisions require modifying so that the proposed amendments do not create unintended anomalies.

06
Trends in Board Risk Management

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A number of trends in risk management have developed this past year that are important for Canadian boards of directors to consider. As we noted in *Governance Insights 2013*, risk management practices regarding corruption of governmental officials remain very important for Canadian companies operating abroad, particularly in emerging markets. Boards must also address issues regarding cyber risks and the protection of data belonging to third parties. A similar and relatively new issue is the implementation of extensive anti-spam legislation in Canada, particularly because it focuses responsibility for compliance on board members individually. These developments are discussed in more detail in this chapter.

Anti-Corruption Regulation

FOREIGN CORRUPT PRACTICES

The *Corruption of Foreign Public Officials Act* (CFPOA) is Canada's principal legislation combating bribery of foreign public officials with respect to international business transactions. The CFPOA prohibits anyone from giving or offering a loan, reward, advantage or benefit of any kind to a foreign public official to obtain a business advantage and as consideration for an act or omission by the official.

Although the offence initially seems straightforward, it includes a number of technical elements that are important:

- Even an agreement to offer such a benefit is prohibited. An offence can be committed even if no benefit is actually given. One individual has been convicted and sentenced to a prison term on this basis.
- "Indirectly" giving or offering a prohibited benefit is also an offence; therefore, arranging for a payment to be made through a third party is likely an offence.
- The concept of an "advantage or benefit of any kind", which Canadian courts have yet to consider the scope of, leaves open the possibility of even relatively small benefits contravening the CFPOA. The offence can clearly apply to non-monetary forms of benefits, such as free or subsidized housing or tuition.

- The prohibition applies to benefits or advantages offered or given not only to legislators or judges, for example, but also to anyone holding an administrative position with a foreign state and to employees of state boards, commissions or corporations that are performing duties on behalf of a "foreign state". The prohibition applies only in respect of persons currently holding such a position, not former or anticipated public office holders.
- An advantage conferred on a third person (*e.g.*, a relative or friend of a foreign public official) may violate the CFPOA if it benefits a foreign public official.
- A corporation can be liable for prohibited benefits agreed to or made by its officers or employees.
- To constitute an offence, the benefit must have been to obtain or retain an advantage in the course of business (which includes non-profit activities).

In addition, an amendment to the CFPOA in 2013 and discussed in *Governance Insights 2013* provides for the removal of an exemption for certain types of facilitation payments once this amendment is proclaimed in force. In the meantime, certain types of payments to expedite or secure performance of routine matters within a foreign official's duties are deemed not to be a benefit for the purpose of the CFPOA's main prohibition on foreign bribery.

The 2013 amendments to the CFPOA also added a new offence for certain deceptive bookkeeping practices "for the purpose of bribing a foreign public official" for a business advantage or to hide such bribery. Examples include keeping separate accounts that do not appear in official records, not recording transactions, recording non-existent expenditures, falsely describing entries, and early destruction of records.

Among other possible consequences, a violation of the CFPOA is subject to a fine in the discretion of the court and imprisonment of up to 14 years. CFPOA offences are not subject to any limitation period. Conviction for a CFPOA offence may also disqualify a corporation and its affiliates from federal or provincial government contracts in Canada, as well as from foreign government contracts or contracts financed by international organizations such as the World Bank or the African Development Bank.

DOMESTIC BRIBERY

The Canadian *Criminal Code* (the Code) prohibits anyone from giving or offering a loan, reward, advantage or benefit of any kind to a federal or provincial government official in Canada as consideration for cooperation, assistance, exercise of influence, or an act or omission in connection with any government business.

As with the CFPOA, it is also an offence to agree to give or offer such a benefit. The prohibition extends to indirect gifts or offers, as well as to benefits given to members of the official's family or to other persons for the official's benefit. The offence may be committed even if the official is not in fact able to provide the requested assistance or cooperation.

The Code offences are punishable by fines in the discretion of the court or imprisonment of up to five, or in some cases, 14 years. As with the CFPOA, no limitation period applies. The potential for civil actions, disqualification, forfeiture and parent company liability discussed above in relation to CFPOA offences apply in respect of these Code offences as well.

SENTENCES FOR CFPOA VIOLATIONS: *KARIGAR* CASE STUDY

Perhaps the most striking development in 2014 in this area was the sentencing in May 2014 of Mr. Nazir Karigar. He was sentenced to three years in prison for agreeing, in his capacity as an agent of a Canadian business, Cryptometrics Canada Inc., to offer to pay millions of dollars in bribes to Air India officials and India's then-Minister of Civil Aviation in relation to a bid for a security contract valued at approximately US$180 million.[29] Mr. Karigar is the first individual to be sentenced under the CFPOA. The decision is notable not only for the length of the prison term, but also for the fact that the conviction was based upon an agreement to offer bribes. In fact, the Crown did not prove that an actual payment was made to foreign public officials and the contract was not awarded to Cryptometrics.

The severity of the sentence imposed on Mr. Karigar highlights the willingness of courts to impose significant incarceration sentences on individuals, in spite of their cooperation. This is consistent with the imposition of substantial fines on corporations, even where guilty pleas were entered. Interestingly, Mr. Karigar's sentencing was not the end of the enforcement efforts against Cryptometrics. In June 2014, the RCMP charged U.S. nationals Robert Barra (former Cryptometrics CEO) and Dario Berini (former Cryptometrics COO) under the CFPOA. U.K. national Shailesh Govindia, an agent for Cryptometrics, was also charged under the CFPOA and with one count of fraud contrary to section 380 of the Code.

IMPLICATIONS

Canadian businesses that deal with public officials should implement policies to ensure that their officers, employees and agents are aware of these CFPOA and Code provisions. Periodic audits of operations having regular government interaction on behalf of the business can assist in conveying the importance

29 *R v Karigar*, 2013 ONSC 5199.

of the policy and avoiding transgressions of applicable law. The United States and many other countries also vigorously enforce their own domestic anti-corruption legislation and prohibitions on foreign corrupt practices. Accordingly, multinational businesses may be subject to multiple anti-corruption regimes in respect of the same conduct.

Prospective purchasers of businesses should conduct due diligence on a target company's operations that interface with government to help assess the risk of fines or penalties in relation to past conduct, as well as the risk of the purchaser and its other affiliates becoming disqualified from future government contracts. Once an entity and its affiliates are debarred from government contracts on this basis, the term for disqualification can be indefinite, and the prospects for requalifying unclear.

Cyber Security Risks

Cyber security, or protecting against harmful activity executed through computers, IT systems and/or the Internet, is one of the fastest growing risk-management issues for issuers and governments this year. OSFI now ranks cyber security as one of its top concerns due to "the rapid evolution of cyber attacks in terms of frequency, fire power and targets".[30] Given the increasing dependence by issuers, governments and consumers on technology, we expect the risk for cyber attacks to increase for the foreseeable future. Cyber attacks and data breaches are no longer a matter of *whether* they will occur, but *when* they will occur.

Although the management of cyber security issues is the responsibility of the issuer, as a result of its elevation in importance, cyber security has become an issue for consideration by boards, as was noted by SEC Commissioner Luis A. Aguilar in June 2014. Among other points discussing the risk of cyber security, Commissioner Aguilar noted that "ensuring the adequacy of a company's cybersecurity measures needs to be a critical part of a board of director's risk oversight responsibilities" and that board oversight "is critical to preventing and effectively responding to successful cyber-attacks". Undoubtedly shaping Mr. Aguilar's views are the many high-profile cyber attacks in recent years, responsible for the release of, among other things, personal and financial information for over one hundred million consumers across the United States and Canada. These high-profile breaches include the following:

30 Julie Dickson, Superintendent, Office of the Superintendent of Financial Institutions, Remarks by Superintendent Julie Dickson to the 2013 Financial Services Invitational Forum (May 2, 2013), available at: http://www.osfi-bsif.gc.ca/Eng/osfi-bsif/med/sp-ds/Pages/jd20130502.aspx.

- **Heartland Payment Systems, Inc.:** Heartland announced a breach in 2009 resulting in data being stolen that were sufficient to produce counterfeit credit cards, with more than 130 million cards issued by over 650 financial services companies estimated to have been compromised. The breach led to Heartland paying over $145 million in compensation for fraudulent payments and caused a significant loss of revenue for the company.
- **Sony Corporation:** Sony announced a massive breach of its online network for its PlayStation console in 2011, resulting in the theft of names, addresses, usernames, passwords and possibly credit card data of 77 million user accounts. Sony came under fire for its delay in informing the public about the breach. A class action lawsuit was subsequently filed by customers and Sony agreed to a preliminary settlement in 2014 for $15 million. Authorities in the United Kingdom also fined Sony £250,000 for a breach of its *Data Protection Act*.
- **Target Corporation:** In December 2013, U.S.-based retailer Target learned of a major system breach, resulting in the theft of customer credit and debit card information, as well as other personal customer information. The breach occurred during the busy holiday selling season and it was estimated that about 70 million individuals were affected. In response, Target offered a year of free credit-screening services to customers and, in the second quarter of 2014, estimated that the breach had cost Target about $148 million.
- **eBay Inc.:** In May 2014, eBay recommended that all customers change their passwords after an attack that exposed customer data, although financial information was not affected. It is estimated that hackers accessed 145 million records containing customer names, email addresses and other personal information. eBay was criticized for failing to notify customers immediately upon discovering the breach and is now subject to a class action lawsuit in the United States.
- **Home Depot Inc.:** Home Depot announced in September 2014 that its payment data systems (including both credit and debit cards) were accessed by unknown hackers. While the breach is still being investigated, Home Depot indicates that about 56 million customer cards may have been compromised. BillGuard, a credit protection firm, believes the theft could lead to as much as $3 billion in fraudulent purchases. It is expected to cost Home Depot about $62 million alone to cover the initial expenses relating to the breach, and may still result in legal action.

- **JPMorgan Chase & Co.:** In October 2014, U.S.-based financial institution JPMorgan Chase announced a breach consisting of the theft of personal information (including names, phone numbers and email addresses) and certain other internal JPMorgan Chase information about approximately 76 million households and 7 million small businesses. JPMorgan Chase has disclosed that the stolen information does not include customer account information, such as account numbers or passwords. At the time of preparing *Governance Insights 2014*, the full extent of the breach had not been determined and no information about the estimated or actual costs of this breach to JPMorgan Chase or its customers was publicly available.

Boards of Canadian issuers, particularly issuers with large databases of customer payment information, valuable proprietary technology and/or exposure to critical or financial market infrastructure, should carefully consider their oversight of risk management efforts regarding cyber security. Effective oversight leads to the best protection of:

- the issuer, against cyber attacks and lawsuits for inadequate risk controls, oversight or disclosure about cyber security risks; and
- directors personally, to satisfy their statutory and fiduciary obligations to the issuer and ensure that they have acted in such a way as to qualify for protection under the business judgment rule against any lawsuits seeking personal liability.

Effective oversight also ensures that publicly listed Canadian issuers are best positioned to comply with applicable securities laws, which include specific guidance from Canada's provincial securities regulators in CSA Staff Notice 11-326 *Cyber Security* (SN 11-326) about safeguarding against cyber attacks. The guidance includes the following:

- Be aware of the challenges of cyber crime and take the appropriate protective and security hygiene measures necessary to safeguard the issuer and its clients or stakeholders.
- Educate employees on the importance of, and their role in, ensuring the security of the information and computer security of the issuer and its customers.[31]

31 Although many Canadian businesses and governments have been, and continue to be, the target of cyber attacks, the most common incidence of large scale data breaches in recent years in Canada has been caused by the theft or accidental loss by employees of data storage devices (*e.g.*, USB keys or data tapes) or mobile computing devices (*e.g.*, laptop computers) outside the workplace. Notable breaches include compromises to the personal information of over 80,000 people by Durham Region Health Department in 2010, over 500,000 people by Human Resources and Skills Development Canada in 2012, and over 50,000 people by Investment Industry Regulatory Organization of Canada in 2013.

- Follow guidance and best practices from industry associations and recognized information security organizations.[32]
- Conduct regular third-party vulnerability and security tests and assessments.
- Review cyber security risk control measures on a regular basis.

SN 11-326 does not provide specific guidance on satisfying general disclosure obligations of an issuer for material risks and changes in the context of cyber security; however, helpful reference can be made to guidance on disclosure of cyber security issues from the SEC in its CF Disclosure Guidance: Topic No. 2, provided in 2011.[33]

Although SN 11-326 offers only guidance to issuers, privacy laws across Canada require that issuers have basic safeguards against unauthorized access to personal information. Proven measures to improve risk management practices relating to cyber security include the following:

- clearly identifying who on the board and at the issuer is responsible for cyber risk management;
- investing in dedicated cyber security personnel;
- implementing technical security measures;
- obtaining cyber security insurance coverage; and
- preparing a formal incident response plan for cyber attacks.

Canada's New Anti-Spam Legislation

After many years of stakeholder consultations and anticipation, effective July 1, 2014 a majority of the provisions of Canada's new anti-spam law (CASL) came into force.[34] While many boards and businesses might assume that, by

32 Two leading frameworks for guidance are, in Canada, OSFI's Cyber Security Self-Assessment Guidance, which is directed at financial institutions but useful for all issuers (available at: http://www.osfi-bsif.gc.ca/Eng/fi-if/in-ai/Pages/cbrsk.aspx); in the United States, the Commerce Department's Framework for Improving Critical Infrastructure Cybersecurity (available at: http://www.nist.gov/cyberframework/upload/cybersecurity-framework-021214.pdf).

33 Available at: http://www.sec.gov/divisions/corpfin/guidance/cfguidance-topic2.htm.

34 *An Act to promote the efficiency and adaptability of the Canadian economy by regulating certain activities that discourage reliance on electronic means of carrying out commercial activities, and to amend the Canadian Radio-television and Telecommunications Commission Act, the Competition Act, the Personal Information Protection and Electronic Documents Act and the Telecommunications Act, SC 2010, c 23.*

virtue of the Act's title, its provisions are not likely to capture their company's activities, CASL is arguably the most radical of its international counterparts, in terms of both its broad scope and the severe administrative penalties and other consequences it imposes for non-compliance. Accordingly, boards and senior management would be wise to assess their current practices, including relating to electronic communications, to determine whether CASL applies to their organizations and, if so, to take immediate steps to bring the company into compliance.

Effective July 1, CASL, among other things, makes it illegal to send or cause or permit to be sent a commercial electronic message (more commonly referred to as "spam") to an electronic address without the express or implied consent of the recipient and without including certain prescribed disclosure in the electronic message. CASL has also effected certain amendments to the *Competition Act* (Canada), making it illegal for any person to send or cause to be sent a false or misleading representation (whether or not material) in the "sender information", "subject matter information" or the "locator" (*i.e.*, URL) of an electronic message, or in the message itself (if false or misleading in any material respect), having potentially serious implications for businesses that carry on any electronic marketing activities.

Effective January 1, 2015, CASL will also make it illegal to (i) install certain types of computer programs onto computer systems without the *express* consent of the owner/authorized user of the computer system and without first providing certain disclosure about the computer program; and (ii) having so installed a computer program, causing it to send a message from the computer system. This provision targets computer programs commonly known as "spyware" or "malware".

Directors and officers will be personally liable if they directed or acquiesced in the commission of a CASL violation, unless they can establish due diligence.

For boards of public and private companies, of most importance is the broad-reaching application of the provisions of CASL and related amendments to the *Competition Act*, which would capture many types of legitimate business activities that one might have expected should fall outside their scope or previously had not been regulated. In addition, CASL imposes multiple and potentially overlaying penalties on violators, with broad and extraterritorial enforcement rights given to the Canadian Radio-television and Telecommunications Commission (CRTC), the Competition Bureau and Canada's Privacy Commission. CASL contemplates, among other things, severe administrative monetary penalties of $1 million for individuals and up to $10 million for all other persons *per* violation of the anti-spam or anti-spyware provisions (up to $15M for subsequent violations of the *Competition Act* amendments by corporations). The enforcing regulatory bodies also have broad powers to conduct searches, execute search warrants, and obtain production of documents, among other things.

In addition to direct liability, it is prohibited to *aid, induce or procure* breaches of the anti-spam or anti-spyware provisions of CASL. Companies will be vicariously liable for violations committed by employees acting within the scope of their employment. Importantly, directors, officers and agents of a corporation will be personally liable for a violation if they "directed, authorized, assented to, *or acquiesced*" in or participated in the commission of a violation (whether or not the corporation is proceeded against), unless they can establish that they exercised due diligence to prevent the commission of the violation. Lastly, CASL also creates private rights of action (*i.e.*, civil action) in respect of alleged violations, which will come into force on July 1, 2017.

As a result, it would be prudent for boards and senior management to ensure that appropriate policies and procedures are in place and employees are made aware of these, and that any non-compliance is confronted with disciplinary measures. In addition, companies should consider implementing internal control mechanisms to ensure that any electronic marketing materials are reviewed and approved by a marketing director or other senior compliance officer familiar with the rules to ensure their compliance. Lastly, because of the reverse onus placed on companies and their leadership to establish that proper steps have been taken to prevent breaches of the new law, boards and senior management should ensure that adequate records are prepared and maintained evidencing the steps taken to bring themselves into compliance with CASL and the related statutory amendments and to prevent violations of these rules. For further details concerning CASL and its application, please refer to Davies' publicly available *CASL Workbook*.[35]

35 http://www.dwpv.com/en/Pages/CASL.

Key Contacts

Researching and writing this paper was a project undertaken by Davies Ward Phillips & Vineberg LLP and not on behalf of any client or other person.[36] If you would like to discuss any of the issues raised in this report, please contact any of the partners listed below:

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