Research Report: Canadian Governance Highlights from the 2013 Proxy Season

OSLER

A heightened focus on board governance and shareholder engagement this proxy season prompted the research reflected in this Osler report. Our analysis shows how Canadian companies have responded to shareholder demands for a say on pay and international say on pay trends, taken advantage of new flexibility to communicate electronically with shareholders via notice and access in Canada, and adopted advance notice requirements for director nominations and other activist shareholder defence measures.

Table of Contents

Say on Pay 2013: More Failures but Canada Continues Steadily on its Own Course

The number of Canadian companies holding non-binding advisory votes on executive compensation ("Say on Pay" votes) has continued to increase, moving from a reported 97 companies as of June, 2012 to 129 in June, 2013.

However, the average approval level has continued to decline slightly year-over-year. Of issuers which have reported results for 2013 to date, the average level of shareholder approval in 2013 was 89.31%. This reflects a 2.51% decrease from the average total results for all of 2012 of 91.61% and a 4.55% decline from the 2011 average of 93.86%. The decline in the average approval level for 2013 is due to poor results at a few companies.

This year, three Canadian companies failed their say on pay votes: Equal Energy Ltd. (only 43.79% in favour), Golden Star Resources Ltd. (only 38.34%) and Barrick Gold Corporation (only 14.80%). As well, MDC Partners Inc. barely squeaked by with the approval of just 50.24% of the votes cast. Absent these four outliers, the 2013 average total is 91.33%, roughly the same as in 2012 when only one Canadian company failed its say on pay vote. The average approval for companies that held say on pay votes in both 2012 and 2013 was 90.68%.

1 FAILED
VOTE IN 2012

3 FAILED
VOTES IN 2013

Barrick Gold Corp. is the highest profile Canadian company to date to have failed its say on pay vote and represents the lowest level of support for any Canadian company. In fact, it is a record matched by only a very few U.S. companies. Both last year and this year, low support levels for those who fared worst on their advisory votes have often reflected collateral damage arising from public campaigns by dissident shareholders dissatisfied with company performance generally. However, in Barrick's case shareholders were unambiguously angry with the company's decision to award $56.8 million in total compensation to Barrick senior executives, which included an $11.9 million signing bonus to the newly appointed Co-Chair John Thornton, particularly during a year of poor financial performance that saw the stock price tumble dramatically.

COMPANIES WITH RELATIVELY LOWER APPROVALS:

Companies with a significant vote against their say on pay resolution should consider the reasons underlying that vote result and take appropriate action. Where the approval level is less than 70%, Institutional Shareholder Services Canada will consider the company's response to the vote, whether the issues underlying the voting result are recurring or isolated and the company's ownership structure in determining whether to recommend voting against the say on pay resolution the following year. This year, seven companies received less than 70% approval: Equal Energy Ltd., Golden Star Resources Ltd., Barrick Gold Corp. and MDC Partners Inc., as noted above, and Canadian Natural Resources Limited (55.80%), Thompson Creek Metals Company Inc. (62.8%) and Vitran Corporation Inc. (58.56%).

All but one of the five Canadian companies which received less than 70% support last year were able to reverse their performance and exceed that level this year - only MDC Partners failed to exceed the 70% approval level in both years as its results declined from 66.75% in 2012 to 50.24% in 2013.

Our analysis of say on pay approval levels does not include the approval levels of seven companies: Aecon Group Inc., Crescent Point Energy Corp., Crombie Real Estate Investment Trust, International Forest Products Limited, Kingsway Financial Services Inc, Kingsway Linked Return of Capital Trust, and NovaCopper Inc. These companies reported that their say on pay vote passed, but did not disclose detailed voting results. It is possible that some of these companies may have received less than 70% approval on their say on pay resolutions and that average results would be lower if their detailed results were known.

ANNUAL VOTING:

However, virtually all Canadian companies hold such votes annually, with only five companies, Response Biomedical Corp., Midway Gold Corp., Patheon Inc., Vista Gold Corp., and Yamana Gold Inc. deciding to hold such votes every three years.

7 COMPANIES
BELOW 70%

IN 2013

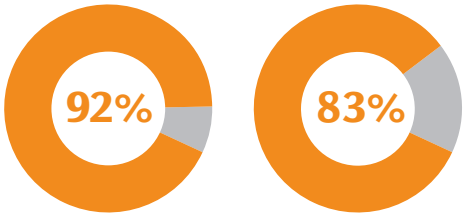
5 COMPANIES
BELOW 70%

IN 2012

2013 CANADIAN SAY ON PAY COMPANY CHARACTERISTICS:

Say on pay votes are generally conducted on a voluntary basis by Canadian companies as there is no legal requirement to conduct such votes under Canadian law. Canadian companies providing say on pay votes come from all industries, but are overwhelmingly larger companies. Of the 129 companies in our analysis, 88 (68.22%) have a market capitalization of over $1 billion, 16 (12.40%) have a market capitalization of between $500 million and $1 billion and only 25 (19.38%) have a market capitalization of below $500 million.

Average Say on Pay Approval Levels



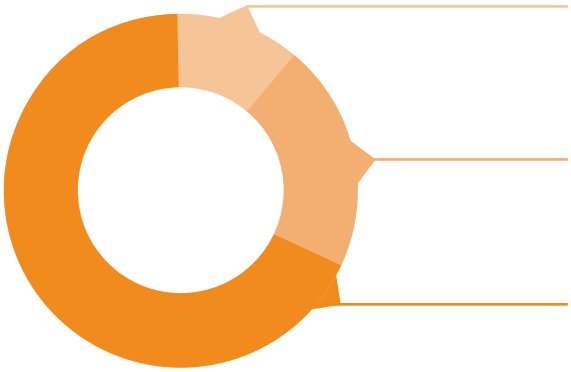
OVER $1 BILLION MARKET CAPITALIZATION

BELOW $1 BILLION MARKET CAPITALIZATION

On average, larger companies had higher approval levels in 2013 than smaller companies - companies with a market capitalization of above $1 billion had an average total say on pay approval of 91.38% compared to an average of 83.10% for all other companies.

Almost all Canadian companies providing say on pay votes in 2013 are listed on the TSX. Only two companies are TSX Venture issuers. Four of the companies are not listed on any Canadian stock exchange. Companies interlisted on a U.S. stock exchange had slightly lower approval levels. The 50 companies jointly listed on the TSX and NYSE had an average of 86.69% and the 10 companies jointly listed on the TSX and NASDAQ had an average of 81.29%. By contrast, in 2013, the 52 companies listed on the TSX that were not interlisted on a U.S. stock exchange had an average approval level of 95.13%.

Market Capital



12% Between $500 M - $1 B
16 COMPANIES

19% Under $500 M
25 COMPANIES

68% Over $1 B
88 COMPANIES

SAY ON PAY INTERNATIONALLY:

United States. Advisory say on pay votes have now been required under U.S. legislation for several years. Steven Hall & Partners, an independent compensation consulting firm, reports that of 2,475 companies which have held say on pay votes to date in 2013, only 49 have failed to obtain shareholder approval and six of them failed their say on pay votes at least once prior to failing the 2013 vote. Cogent Communications, Inc., Comstock Resources, Inc., and Gentiva Health Services, Inc. failed to gain approval once prior to 2013, while Kilroy Realty Corp., Nabors Industries Ltd., and Tutor Perini Corp. have failed every say on pay vote held.

United Kingdom. Recent legislative changes in the U.K. which are expected to come into effect in October, 2013 have expanded on existing requirements to conduct an annual advisory vote on compensation. Under the new legislation, public companies will be required to adopt a directors' remuneration policy which must be approved by shareholders by ordinary resolution at least every three years. Any payments which are not consistent with the approved remuneration policy, including termination payments, will need to be approved by shareholders failing which the directors may be liable to the company for the amount.

Switzerland. In March 2013, Swiss voters approved a proposal that would result in some of the toughest say on pay rules to date. Nearly 68% of the population supported the institution of say on pay votes that would be binding, rather than merely advisory as has been Switzerland's long-standing practice. In addition, companies would no longer be allowed to offer bonuses to executives joining the company (golden handshake) or leaving the company (golden parachute). Violations could be met with fines of up to six years' salary and three years in prison. Further, the proposal would require pension funds holding shares in companies to vote. It is anticipated that legislation to implement the proposal may come into effect in 2014 or 2015.

The European Union. The EU approach to say on pay has focused exclusively on the banking sector. EU legislators are pushing so that bankers will not be permitted to receive a bonus in excess of 100% of their base salary, although a maximum bonus of up to 200% of base salary will be permitted if approved by 67% of shareholders owning 50% or more of the shares, or 75% of votes if there is no quorum.

Australia. Since 2005, Australian companies have held an annual advisory say on pay vote. The vote was modified in 2011 by implementing the "two strikes rule," where if less than 75% of shareholders vote in favour of an executive compensation package for two consecutive years, and shareholders other than key management personnel whose remuneration is disclosed in the remuneration report approve a "board spill resolution", the company is required to hold a new meeting to elect directors within 90 days. So far, few companies have fallen below the 75% threshold for two consecutive years and there are even fewer instances where a board spill resolution has been approved and, if approved, resulted in a change in the board.

Notice and Access Arrives in Canada

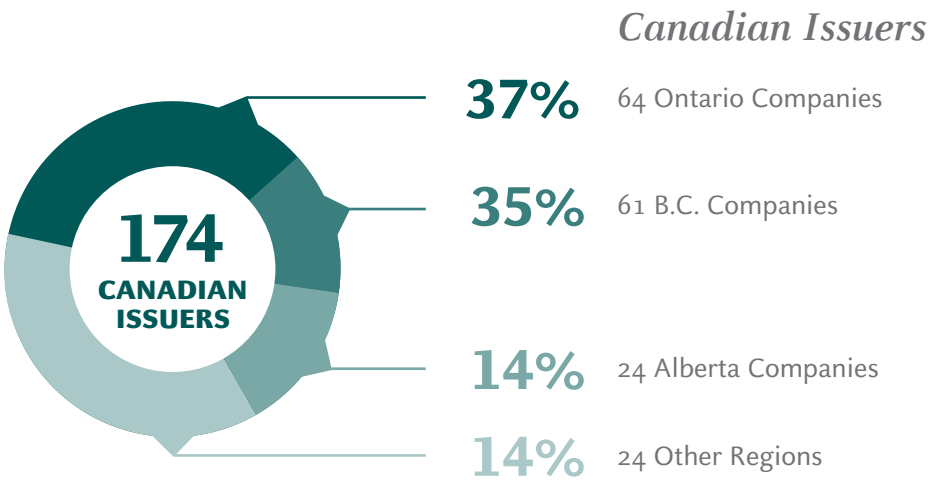
Commencing this proxy season, many Canadian issuers have been able to take advantage of new rules under Canadian securities laws to send proxy materials to security holders electronically instead of mailing out paper copies. Under the new notice and access procedures, security holders are provided with a notice containing details of the date, time and place of the shareholder meeting, including a brief description of the matters to be voted on, and instructions on how to access an electronic copy of the proxy materials or request a paper copy.

Notice and access affords an opportunity to send materials to security holders electronically without obtaining the recipient's prior consent to do so. However, not all Canadian issuers are yet able to utilize notice and access. Under the securities rules, notice and access is not available to investment funds.

In addition, the *Canada Business Corporations Act*, federal financial institution legislation and corporate legislation in Saskatchewan contain consent requirements for electronic delivery that preclude such companies from taking advantage of notice and access.

(Although Corporations Canada issued a notice in February, 2013 stating that it was prepared to grant exemptions to permit CBCA companies to distribute proxy materials to registered shareholders using notice and access, it noted that it does not have authority to grant exemptions to permit such materials to be distributed to beneficial owners in the same manner.) Some issuers may have restrictions under their constating documents that preclude electronic delivery via notice and access.

Relatively few issuers have taken advantage of the new flexibility so far, as most companies preferred to wait until next year when participants in Canada's proxy system will be more experienced with notice and access and shareholders are less likely to be surprised by the change. To date, 174 Canadian issuers have taken advantage of the new flexibility afforded under notice and access. Of these, 64 (36.78%) are Ontario companies, 61 (35.06%) are B.C. companies and 24 (13.79%) are Alberta companies. The remainder hail from various other jurisdictions. Surprisingly, there are 13 CBCA companies which have purported to utilize notice and access despite the legal impediments to doing so.



Advance Notice Requirements for Director Nominations Take Off

One remarkable long-standing difference between Canadian and U.S. practice with respect to director nominations has been the U.S. practice of including in their company by-laws provisions requiring advance notice to the company of any intent to propose nominees for director. Such provisions have historically been absent from the constating documents of Canadian companies. But the tide has turned this proxy season as a large wave of Canadian issuers, generally smaller companies, have adopted advance notice provisions.

This change is phenomenal. Our research identified 518 Canadian issuers, which by June 19, 2013, had adopted or proposed adoption of advance notice provisions.

Of these, 0.39% adopted or proposed such provisions in 2011 or earlier, 10.2% in 2012 and the remaining 89.41% in 2013.

Adoption of Advance Notice

0.4% Adopted advance notice provisions in 2011 or earlier

10% Adopted advance notice provisions in 2012

89% Adopted advance notice provisions in 2013

WHAT HAS PROMPTED THIS CHANGE?

The increase in shareholder activism in Canada in recent years caused companies to consider adoption of additional defences to shareholder activism, including the adoption of advance notice provisions to preclude the possibility of a surprise nomination of directors at a shareholder meeting.

Advance notice provisions require shareholders to submit notice to the board of directors of the shareholder's intention to nominate individuals to serve as directors a certain number of days prior to the date of the meeting. Failure to comply with a valid advance notice provision can result in the shareholder being denied the right to make nominations at the meeting and, as a result, advance notice provisions preclude shareholders from launching a surprise attack at or shortly before the shareholders meeting.

504

AND CLIMBING

The number of Canadian issuers that have adopted advance notice provisions since the release of *Mundoro* decision

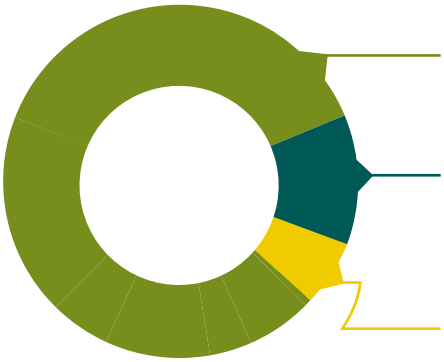
The triggering event for this change in practice was the release on July 20, 2012 of the decision of the Supreme Court of British Columbia in *Northern Minerals Investment Corp. v. Mundoro Capital Inc.* In *Mundoro*, the board of directors of the company adopted a board policy requiring shareholders to provide advance notice of any intention to make director nominations at the shareholder meeting. The dissident sought a declaration that the board policy was unenforceable. The court declined to do so and concluded that the board policy was reasonable and served a valid purpose.

The number of Canadian issuers which have adopted or proposed advance notice provisions since the release of the *Mundoro* decision is 504 and climbing.

WHO IS ADOPTING ADVANCE NOTICE PROVISIONS?

Although the number of Canadian issuers that have adopted advance notice provisions is fairly large and continues to grow, adopters tend to be smaller issuers engaged in extractive industries, such as mining and oil & gas.

73.75% of the Canadian issuers that have adopted or proposed such provisions have market capitalizations of less than $100 million, 19.31% have market capitalizations of between $100 million and $1 billion and only 6.95% of them have a market capitalization of more than $1 billion.



74% Of adopters have market capitalizations of less than $100 M

19% Of adopters have market capitalizations between $100 M and $1 B

7% Of adopters have market capitalizations of more than $1 B

The largest cap issuers to have proposed or adopted advance notice provisions in Canada are Agnico-Eagle Mines Limited, Bombardier Inc., Canadian Oil Sands Limited, Crescent Point Energy Corp., Metro Inc., Pacific Rubiales Energy Corp., RioCan Real Estate Investment Trust, SNC-Lavalin Group Inc., TELUS Corporation, Tim Hortons Inc. and Valeant Pharmaceuticals International, Inc.

In light of this breakdown, it is not surprising that a large percentage of issuers (57.34%) are TSX Venture Exchange issuers. A total of 39.38% are listed on the TSX and the remaining 3.28% are listed on other exchanges or are not listed.

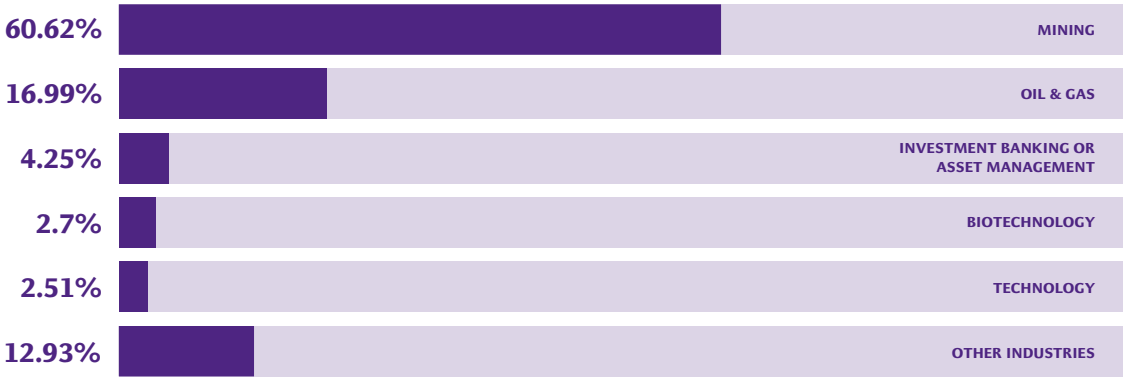
60%

TSX Venture Exchange Listed

40%

TSX Exchange Listed

In terms of industry, 60.62% of issuers are in mining and 16.99% are in oil & gas. Outside of those industries, approximately 4.25% of issuers are in investment banking or asset management, 2.7% are in biotechnology, a further 2.51% are in technology and no other industries represent a meaningful proportion of the remaining 12.93% of issuers.



WHERE DO ADVANCE NOTICE PROVISIONS RESIDE?

Although the court in *Mundoro* considered an advance notice provision adopted as a board policy, most issuers have sought, or will seek, shareholder approval to incorporate advance notice provisions in their by-laws or articles. Approximately 67.95% have sought shareholder approval of new or revised by-laws or articles, or other changes to their constating documents to incorporate advance notice provisions, or have included it as an item of business at their next shareholder meeting. Approximately 2.3% of issuers had incorporated advance notice provisions in their constating documents before going public.

In many cases, advance notice provisions were first adopted as a board policy before the new or revised by-laws or articles were submitted to shareholders for approval. For companies incorporated under the *Canada Business Corporations Act* and similar corporate statutes, the board of directors may amend the by-laws of the company to require advance notice of director nominations with immediate effect, subject to the effectiveness of such provision lapsing if not ratified by shareholders at the next shareholder meeting.

As that alternative is not available to British Columbia companies, many of them have begun by adopting an advance notice provisions as a board policy with a view to such provisions having immediate effect.

70%

Include advance notice provisions in their constating documents

30%

Approved an advanced notice policy

Approximately 29.54% of Canadian issuers however, have adopted advance notice provisions solely in the form of a policy. Of those issuers which to date have elected to adopt advance notice provisions in a policy rather than as part of their constating documents, 47.71% have already submitted the policy to shareholders for approval, while 8.50% have adopted or proposed to adopt advance notice solely as a board policy and have chosen not to seek approval at a subsequent shareholder meeting. 15.69% have proposed shareholder approval of the board policy but have yet to hold their meeting.

WHAT PERIOD OF NOTICE IS REQUIRED?

In the U.S., where advance notice provisions have been part of the landscape for decades, deadlines for shareholders to provide notice of director nominees are typically a minimum of 60 to 90 days and frequently 90 to 120 days prior to the meeting date. However, in *Mundoro*, the board policy provided that the nominating shareholder had to provide notice not more than 65 and not less than 30 days prior to the meeting date.

The principal proxy advisory firms in Canada, Institutional Shareholder Services Inc. (ISS) and Glass, Lewis & Co., LLC (Glass Lewis) have each stated that they would generally support the use of reasonable advance notice provisions by Canadian issuers. ISS states that "[t]o be reasonable, the company's deadline for notice of shareholders' director nominations must not be more than 65 days and not less than 30 days prior to the meeting date" (although its policies for U.S. companies provide for a longer time frame as they state that the deadline "must not be more than 60 days prior to the meeting, with a submittal window of at least 30 days prior to the deadline"). Similarly, Glass Lewis states that advance notice provisions should be "generally between 30 and 65 days prior to the date of the meeting".

In light of *Mundoro* and the stated views of proxy advisory firms, it is not surprising that the standard which has been adopted by the vast majority of Canadian issuers is an advance notice deadline of not more than 65 and not less than 30 days prior to the meeting date. The vast majority of issuers follow a common formulation of the timeframes for giving notice and some companies which diverged from the standard formulation failed to receive shareholder approval of their advance notice provisions. However, there are a few exceptions. For example, the standard formulation of the deadline does not work as a practical matter for Canadian issuers that are required to comply with U.S. proxy rules, and ISS is prepared to accept a slightly longer period of advance notice as a result.

HAVE SHAREHOLDERS BEEN SUPPORTIVE OF THE ADOPTION OF ADVANCE NOTICE PROVISIONS?

The adoption of advance notice provisions in the standard formulation generally has not proven to be controversial. For those issuers reporting detailed voting results, the average level of support had been 90.71%.However, only a subset of issuers actually provide detailed voting results since a majority of adopters are TSX Venture issuers and such issuers are not required to file a report on voting results.

Three issuers have proposed advance notice provisions which failed to achieve the requisite level of approval. They included Equal Energy Ltd. (55.84% against), Lightstream Resources Ltd. (previously PetroBakken Energy Ltd.) (58.29% against) and Petrominerales Ltd. (54.88% against). One issuer, Vitran Corporation Inc., withdrew its proposal before the vote was taken at the meeting. Note that if advance notice provisions are adopted as new or revised by-laws or articles, ISS will also review the issuer's by-laws or articles generally for compliance with ISS requirements relating to quorum for meetings of shareholders and of directors, the absence of a casting vote for the chair of the board, the absence of alternate director provisions and other corporate governance concerns. Even if the issuer is only proposing to add an advance notice provision to its by-laws or articles and is not proposing any other changes to its constating documents, if ISS requirements are not met, ISS will generally recommend against approval of the change.

CONCLUSIONS

While they may not fit perfectly into our Canadian system of corporate law, advance notice provisions ensure that shareholders are able to make informed choices about nominees for the board of directors. With the support they have received and as long as the provisions are properly drafted, they are worth considering in anticipation of a contested meeting.

91%

Average approval level

The Enhanced Quorum By-Law: A New Governance Tool

The adoption of advance notice provisions is not the only way Canadian issuers have responded this proxy season to the rise of shareholder activism in Canada. Osler helped Canadian Oil Sands Limited implement an enhanced quorum by-law requirement to help ensure that when the composition of a majority of the board is at stake, more than 50% of the outstanding shares are involved in electing the directors.

The percentage of outstanding shares that need to be represented in person or by proxy at a shareholder meeting in order to conduct business can vary. While Institutional Shareholder Services (ISS) generally insists that companies require at least 25% of the outstanding shares be represented at the shareholder meeting to constitute quorum for the conduct of business, there are many examples where the quorum requirement is set as low as 10%. With a quorum requirement of 10%, a shareholder with just over 5% of the outstanding shares can replace the whole board.

A significant change to the composition of a board can result in a new board which lacks necessary skills or expertise, or which is not comprised of an adequate number of independent directors or resident Canadian directors and may trigger "change of control" provisions in incentives, employment contracts, debt facilities and material contracts.

If such dramatic changes are to be made, they should reflect the wishes of a sizable number of shareholders after having had adequate time to consider the arguments for and against such changes as they may have a fundamental impact on the business and strategic direction of the issuer.

Where a change in the majority of the board is at stake, the enhanced quorum by-law will require at least 50% of the issued and outstanding shares be voted to consider that significant change.

The enhanced quorum by-law, as developed, could not be used to defeat the wishes of shareholders to change a majority of the board as failure to meet the quorum requirement would result in an adjournment of the meeting for a maximum of 65 days. When the adjourned meeting reconvenes, those shareholders present in person or by proxy at the reconvened meeting shall constitute a quorum and the vote on directors will proceed.

These 65 days should afford sufficient time for the company and the activist shareholder to get their messages out to a broad group of shareholders and to engage with shareholders on the issues and the choices for directors before the vote is taken.

The enhanced quorum by-law can be used in conjunction with an advance notice by-law provision as the two are complimentary. The advance notice by-law requires information to be submitted with sufficient time to be considered. By contrast, the enhanced quorum by-law ensures that a sufficient number of shareholders are expressing their view and voting on the issue.

The proxy advisory firms (Glass Lewis and ISS) also supported its implementation by providing a positive recommendation for its adoption, with Glass Lewis specifically indicating that it agrees that such enhanced quorum will serve to protect shareholder interests. Canadian Oil Sands' enhanced quorum by-law proposal was approved by 99% of the votes cast at its annual meeting this year.

OSLER.com

Osler, Hoskin & Harcourt LLP