CORPORATE GOVERNANCE REVIEW

Volume 18 No.5 August / September 2006

Don't Mess With That Option Plan

by Debra Sisti and William Mackenzie

Those of us who live and breathe for proxy season foresee some extra work coming in 2007. Option plans and any other share-based compensation plans will need to have their Amending Procedures sorted out. The Toronto Stock Exchange (TSX) Company Manual prescribed a list of plan constraints and required material amendments to be approved by shareholders. Today it is possible to have a number of key plan provisions, some previously made untouchable by the TSX, now set out as provisions that can be amended at the sole discretion of the plan administrators. But first, shareholders have to approve specific Amending Procedures, either in the form of an existing plan amendment or within a brand new plan. If new Amending Procedures are not in place by June 30, 2007, the administrators will have no discretion to amend any provision. Consequently, we anticipate, mixed with spring showers next April, a good deluge of option plan amendments.

For many years, the TSX had established certain mandatory requirements for equity-based plans. Option terms could not exceed 10 years, awards could not be assignable, no individual could be granted awards for more than 5% of the outstanding shares; and discounted options were not permitted and shareholder approval was required for any material amendment including but not limited to the following types of amendments[1]:

- Any amendment to the number of securities issuable;
- Any change to the eligible participants which would have the potential of broadening or increasing insider participation.
- The addition of any form of financial assistance.
- Any amendment to a financial assistance provision which is more favourable to participants.
- The addition of a cashless exercise feature, payable in cash or securities which does not provide for a full deduction of the number of underlying securities from the Plan reserve.
- The addition of a deferred or restricted share unit or grant of shares.

Now the TSX will require only the following three types of amendments be subject to security holder approval, regardless of revised Amendment Procedures adopted by any issuer:

In This Issue

P.1 **Effective immediately: ISS Canada updates** policy guidelines on the amending procedures of equity-based compensation plans for TSX companies.

P.3 **Alex Todd discusses a research report looking** at appropriate styles of corporate governance.

P.7 **Our eleventh annual review of proxy voting** trends shows a slow and circular progression towards full disclosure.

P.14 **Company News includes updates on poison** pills, OSC refilling and errors list,majority vote adoptions update, and three recent proxy contests.

A bi-monthly publication of

ISS

INSTITUTIONAL SHAREHOLDER SERVICES

Suite 1400, 67 Yonge St., Toronto, ON, M5E 1J8
Phone 416 364 9000, Website: www.issproxy.com
Institutional Shareholder Services Canada Corp.

- Any increase in the number of shares reserved.
- Any reduction in exercise price which benefits an insider[2].
- Any amendment that extends the term of an award beyond its original expiry and that benefits an insider of the issuer.

In addition, the TSX requires that the exercise price for any stock option granted under a security based compensation arrangement or otherwise, must not be lower than the market price of the securities at the time the option is granted.

New disclosure requirements include annual disclosure of the terms of any security based compensation arrangement including specific amending powers, as well as any amendments that were adopted in the most recently completed fiscal year, including whether or not security holder approval was obtained for the amendment. Such disclosure must be as of the date of the information circular containing the relevant disclosure and the issuer must update disclosure for the most recently completed fiscal year end to include grants, exercises, amendments, etc. which may occur after the fiscal year end is completed, but prior to the filing of the information circular.

ISS POLICY REVISION FOR ALL TSX LISTED ISSUERS

After discussions with several clients, law firms, issuers and other experts ISS Canada has determined that some key provisions must be carved out of the amending powers of the plan administrators. These are the basis for an updated Canadian voting policy guideline which is summarized below. The policy is now in effect and will soon be posted on the www.issproxy.com website in the "Policy Gateway" area of the site.

ISS Canada will generally recommend AGAINST the approval of proposed Amendment Procedures that do not require shareholder approval for the following types of amendments under any security based compensation arrangement, whether or not such approval is required under current regulatory rules:

- Any increase in the number of shares reserved.
- Any reduction in exercise price or cancellation and reissue of options.
- Any amendment that extends the term of an award beyond the original expiry.
- Amendments to eligible participants that may permit the introduction or reintroduction of non-employee directors on a discretionary basis.
- Any amendment which would permit equity based awards granted under the Plan to be transferable or assignable other than for normal estate settlement purposes.

ISS Canada has reiterated the need for shareholder approval for the three amendments that currently still require shareholder approval by the TSX due to the ability of the TSX to change or eliminate these requirements at any time in future. Consistent with ISS Canada's longstanding guidelines for security-based compensation plans, we do not believe the exercise price or term of options should be amended without shareholder approval, if at all.

To enhance director accountability, and avoid potential self-dealing, ISS Canada considers discretionary participation by non-employee directors grounds to oppose share-based compensation plan proposals. A plan should provide very limited discretion, if at all, for participation by non-employee directors. Such limits must not be within the scope of the administrators amending powers.

ISS Canada takes the position that the ability of plan participants to assign options by means of Option Transfer Programs or any other similar program which results in option holders receiving value for underwater options from a third party (eg: broker/dealer) is not consistent with the intended purpose of such plans (eg: attract, retain and provide an incentive).

ISS Canada will continue to run its proprietary compensation model to evaluate security based compensation plan proposals including those seeking approval for Amendment Procedures, whether in new plans or old, in order to ascertain the effect of the proposed or potential amendments on the cost of the plan.

The following will be captured as a cost increase in the compensation model, increasing the likelihood of an AGAINST recommendation:

- Amendments to option terms;
- Accelerating option expiry dates;

- Amendments to types of awards, i.e. addition of RSUs
- Amending mechanics of exercise (eg: a cashless exercise where underlying shares are not deducted from the Plan reserve)

The following will not be reflected in compensation model runs:

- Amending mechanics of exercise (eg: when a gain on exercise is realized in cash, the underlying shares are deducted from the plan reserve;
- Altering vesting provisions;
- Addition or amendment to financial assistance.

Although minimum mandatory vesting requirements are found in most institutional investors' voting policies, plans that describe vesting practices have always contained language that gives administrators flexibility to adjust vesting to facilitate employee terminations.

EMPLOYEE STOCK PURCHASE PLANS

ISS generally supports employee stock purchase plans with all of the following provisions:

- Limit on employee contribution (expressed as a percentage of base salary excluding bonus, commissions and special compensation)
- Purchase price is at least 80 percent of fair market value with no employer contribution, OR
- No discount purchase price with maximum employer contribution of up to 20% of employee contribution
- Offering period is 27 months or less, and
- Potential dilution together with all other equity-based plans is ten percent of outstanding common shares or less.

In addition, ISS Canada will generally recommend AGAINST proposals or plans where Amendment Procedures give administrators discretion to amend any of the above acceptable criteria.

[1] Staff Notice #2004-0002, Section 613 Security Based Compensation Arrangements Toronto Stock Exchange.

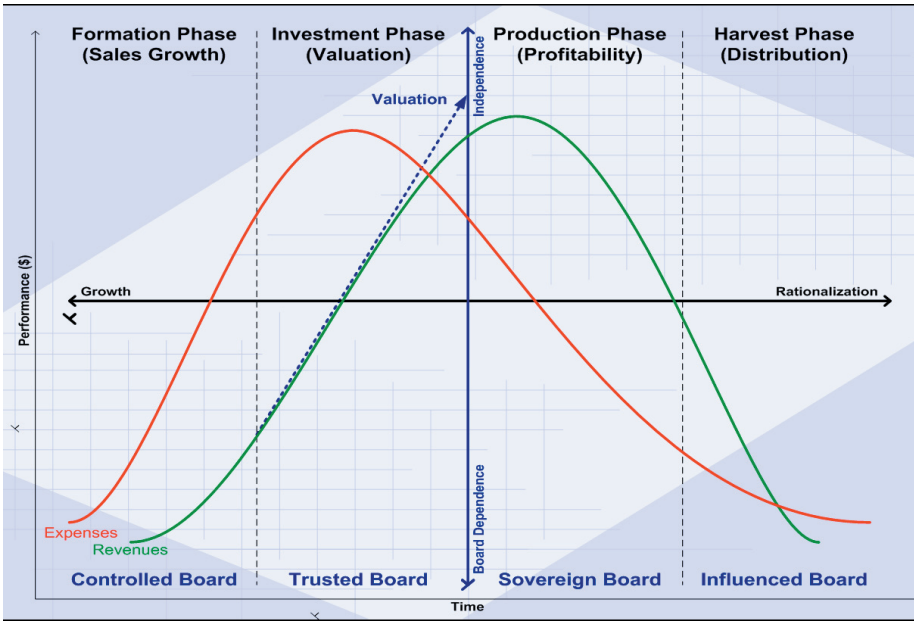
[2] Security holder approval, excluding the votes of securities held by insiders benefiting from the amendment, is required for a reduction in the exercise price, purchase price, or an extension of the term of options or similar securities held by insiders. If an issuer cancels options or similar securities held by insiders and then regrants those securities under different terms, the TSX will consider this an amendment to those securities and will require security holder approval, unless the regrant occurs at least 3 months after the related cancellation. Staff Notice #2005-0001, Section 613 Security Based Compensation Arrangements, S.613(h)(iii) Amendments to Insider Securities.

Corporate Governance Best Practices: One size does not fit all

by Alex Todd, founder and CEO, TE Research

At a time when North American business faces a higher degree of regulation and accountability than was common in the past, corporate boards have been seized with the issue of governance and in how best to improve the level and consistency of regulatory compliance. While the pursuit of improved compliance is an important and necessary goal for the protection and enhancement of public and shareholder confidence it has led to a conventional wisdom that a more independent and engaged board is the prescription for all that ails today's corporate business. While this may often be true, new, soon-to-be-published research reveals that beyond simple regulatory compliance, corporate governance practices standards cannot be consistently applied to different structures in a "one size fits all" approach. What is clear from the research is that the appropriate style of corporate governance in any business is a strategic consideration that is directly influenced by the nature and the relative position of a business on the *corporate lifecycle* of its evolution.

Simply stated, different sets of governance practices are associated with distinct measures of business performance. Corporations need to actively consider their strategic priorities in light of these factors if they are to adopt corporate governance reforms, and corporate and business strategies that enhance both business performance and corporate governance effectiveness.



Conceptual representation of TE Research's Governance Lifecycle Model (GLM) derived from governance research conducted in 2006

Improving regulatory compliance is one of the most important obligations for today's board. But as we move through the early stages of change in today's corporate and business culture, it is clear that the effectiveness of corporate boards will not be measured simply by a regulatory checklist, rather by the ability of institutional investors to also see evidence of proactive corporate initiatives that improve sustainable business performance. Governance management programs, designed to actively seek such improvements by regularly monitoring and refining corporate governance practices in reference to key industry trends, best practices and the shareholders interests can give boards an effective means by which to help direct and sponsor enduring improvements in both business and compliance performance measures.

Corporate governance guru, Peter Dey's recent about-face on corporate governance standards and his comment "that people need to look at what good governance really is", suggests that a more flexible approach is in order. If the primary purpose of for-profit corporations were to make a profit, logic would dictate that good corporate governance practices should, in the very least, help businesses be profitable (often measured by the amount revenues exceed expenses, or the net profit margin, or return on equity, or return on assets). However, corporate strategies for attaining and maintaining profitability vary greatly. Not only do differences exist between privately held and publicly traded corporations, but also within each ownership model. Some corporations are focused primarily on revenue growth, while others on operating profits. Many other companies focus, instead, on shareholder returns in the form of market valuations or cash distributions. With such a diversity of priorities it is important to do more than just recognize the impact of corporate governance on strategic performance but to also understand the nature of this impact and how it changes from business to business? This understanding will tell us a great deal more about how boards of directors can optimize their roles when formulating and executing corporate and business strategy.

We already know from widely accepted literature on the *"monitoring hypothesis"* for governance (in which shareholders rely on a board of directors primarily to manage the "agency costs" of controlling corporate management) why privately held companies require a different brand of governance than public companies. This conventional wisdom also tells us that the board is supposed to monitor, ratify and sanction management on all matters, including corporate and business strategy. Is it possible, however, that different business performance objectives that require different strategies could also benefit from distinct governance practices? In other words, could it be that the answer to the question, "What are corporate governance best practices?" may be "It depends on your ownership structure and your strategy." Under such an approach different corporate

and business strategies may best be served by distinct bundles of governance practices appropriate to their type of business. If so, there would be merit in Mr. Dey's insight that "each board will decide what the right formula is".

EVALUATING THE RELATIONSHIP BETWEEN CORPORATE GOVERNANCE AND BUSINESS PERFORMANCE

In 2004, Lawrence D. Brown and Marcus L. Caylor from Georgia State University published a research paper entitled "Corporate Governance and Firm Performance". They correlated business performance data on 2,327 companies from Compustat with 51 corporate governance provisions from Institutional Shareholder Services (ISS) to conclude that *"firms with relatively poor governance are relatively less profitable (lower return on equity and profit margin), less valuable (smaller Tobin's Q), and pay out less cash to their shareholders (lower dividend yield and smaller stock repurchase)."* They also identified the specific governance factors that contribute most to business performance, saying:

"We find that the 13 factors associated most often with good performance are all directors attended at least 75% of board meetings or had a valid excuse for non-attendance, board is controlled by more than 50% independent outside directors, nominating committee is independent, governance committee meets once a year, board guidelines are in each proxy statement, option re-pricing did not occur in the last three years, option burn rate is not excessive, option re-pricing is prohibited, executives are subject to stock ownership guidelines, directors are subject to stock ownership guidelines, mandatory retirement age for directors exists, performance of the board is reviewed regularly, and board has outside advisors…. We identify seven factors that are associated most often with bad performance, namely, consulting fees paid to auditors are less than audit fees paid to auditors, managers respond to shareholder proposals within 12 months of shareholder meeting, board members are elected annually (no staggered board), a simple majority vote is required to approve a merger (not a super-majority), company either has no poison pill or a pill that was shareholder approved, a majority vote is required to amend charter/bylaws (not a super-majority), and all directors with more than one year of service own stock."

Independently, TE Research has developed a paradigm that reveals a strong correlation between business performance and the enhancement and protection of conditions conducive to creating trust. When considered together with the detailed findings from the Brown and Caylor study, the existence of a similar relationship between the corporate governance practices that help establish trust and business performance was predicted. We therefore used the same "Trust Enablement™ Framework paradigm to assess conditions for trusting corporate governance practices, as a filter, to classify each of the best practices that were associated with enhanced business performance according to their respective roles; as either helping to establish or ensure (protect from a loss or deficiency of) trust. Our findings not only validated our predictions but also identified common characteristics of groupings of governance best practices that were associated with distinct business performance metrics. Four key factors where identified through this process:

1. Control - management controlled companies have ***better sales growth*** performance;

2. Trust - companies with corporate governance practices that help shareholders establish trust enjoy ***higher valuations*** (Tobin's Q);

3. Sovereignty - companies with truly independent boards, both from management and shareholders, are ***more profitable*** (return on equity and profit margins); and

4. Influence – companies with boards that are strongly influenced by management and where shareholders have fewer rights ***pay out more*** to shareholders in dividends and stock repurchases.

It is noteworthy that counter intuitively, Brown and Caylor found governance practices that enhance shareholder rights to be strongly associated with poor business performance. This finding brings to question whether the "*monitoring hypothesis"* for corporate governance is sufficient to describe the role of corporate boards, as one would expect shareholder

empowerment to be the overriding factor that drives a board's monitoring mandate and hence business performance. Moreover, it lends support to the complementary "*mediating hypothesis*" proposed by Lynn S. Stout from the University of California, in her paper "Investors' Choices", namely that "*shareholders also seek to 'tie their own hands' by ceding control to directors….*" In other words, shareholders of public companies generally prefer to trust rather than control their boards.

Consistent with this concept of the board, in a recent article that appeared in Director, the newsletter of the Institute of Corporate Governance, William A. Dimma, author of the book Tougher Boards for Tougher Times, describes "the role of the board as an intermediary between management and shareholders". In contrast with the traditional views of *monitoring* boards being analogous to *judges*, the *mediating* role ascribes more of a *paternal* archetype to the board. Our findings support these views by revealing that shareholders who have reasons to trust their sovereign boards are more often rewarded with higher corporate profitability and share price values.

Our research revealed that governance best practices, such as *the average options granted in the past three years as a percentage of basic shares outstanding did not exceed 3% (option burn rate), board members are elected annually, and company either has no poison pill or a pill that was shareholder approved (in apparent contradiction, otherwise found to be associated with poor business performance), among others* help to establish shareholder trust and are associated with higher share valuations. This leads us to question what other, yet to be defined, governance best practices could corporations adopt in order to further reduce their cost of capital?

Would it be reasonable to expect, for example, that empowering institutional shareholders with an ability to regularly contribute comments directly to the boards of directors could help them to establish even higher levels of trust and confidence in the issuer's ability to sustain superior business performance? In fact, according to a recent article in The New York Times, publicly traded companies are increasingly moving in that direction by opening direct communication between boards and their shareholders. The article asserts "22 percent of the S. & P. 500 reported that their boards had direct contact with shareholder groups. But five years ago, it would have been close to zero." It is evident that improved communication between boards and shareholders can be a significant factor in improving shareholder trust, which is amply rewarded with higher market valuations.

Taking these factors into account it became obvious that there was a large probability that these findings should be viewed through the prism of a Governance Lifecycle Model™ (GLM) that provides a useful roadmap for strategically matching best corporate governance practices to the strategic objectives that typify each phase of a natural corporate lifecycle. For example:

- **Formation Phase: Entrepreneurial** companies may benefit from having corporate governance practices that allow management more **Control** over the board, because entrepreneurial start-ups are typically owner managed and strategically focused on sales revenue growth;

- **Investment Phase: Pre-IPO** (initial **public offering**) companies and publicly traded companies involved in **mergers and acquisitions** (M&A) may benefit from governance practices that build investor Trust, because when raising capital or acquiring assets, companies strategically focus on leveraging higher valuations;

- **Production Phase: Publicly traded** companies may benefit from having corporate governance practices that support board **Sovereignty**, because public companies need to satisfy more stringent corporate governance standards and capital markets expect them to strategically optimize their businesses for **profitability**; and

- **Harvest Phase: Mature or declining** publicly traded companies may benefit from having corporate governance practices that allow management to **Influence** board decisions, because a reliable, "cash cow" company may benefit from strategically adopting a proceeds **distribution** strategy on behalf of its shareholders.

Even more broadly, our findings cast new light on some fundamental issues plaguing corporate governance reform:

a) They reveal a symbiotic relationship between corporate governance and business strategy, making interdependence inherent in the relationship of strategic corporate objectives and complementary corporate governance practices. Neither are stand alone considerations;

b) They suggest a phased, lifecycle approach to corporate governance is an important step in moving beyond simple compliance enhancement, toward helping boards achieve a sustained and positive impact on the overall performance of their business operations;

c) They clarify the arguments in the debate over "shareholder versus stakeholder" theory for corporate governance by demonstrating how, depending on their business strategies, boards can effectively serve the interests of different stakeholders, beyond those of equity shareholders alone;

d) They distinguish between the relative roles of control and trust in corporate governance, by recognizing that each approach to attaining required levels of stakeholder confidence may be valid, depending on the company's business strategy; and

e) They indicate the essential nature of the board to be a supportive and mediating *paternal* archetype that adaptively serves the evolving needs of the corporation throughout its lifecycle, rather than a dispassionate and rigid *judge* of good and bad management.

Practically speaking, we hope these insights will help corporate governance policy makers decide on pressing issues, such as board composition of closely controlled corporations and governance best practices for income trusts. Corporate directors can benefit by starting a program to proactively and productively manage their own governance practices relative to their companies' strategic priorities, beyond simply managing the risks of regulatory compliance and their liability exposures.

Such an approach can present a real opportunity for corporate boards to make meaningful contributions to the specific needs of their organizations and in doing so respond to Mr. Dey's notion of developing "their own brand of corporate governance best practices" with enlightenment and impactful strategic thinking.

Alex Todd is founder and CEO of TE Research, the research arm of Trust Enablement Inc. that specializes in helping corporations achieve their business goals by optimizing the trust of their stakeholders. The governance research report discussed in this article can be ordered by writing to AlexTodd@TrustEnablement.com.

Shareholder Votes Loud and Clear Despite Muffled Reporting of Vote Results

by Julie Scott and Michelle Tan

Seemingly oblivious to the push of regulation or the pull of shareholder activists, Canadian issuers show no discernable improvement in filing meaningful voting reports. Our annual survey of voting results shows that timeliness has improved slightly overall while the quality of disclosure has stagnated. Yet despite this lack of transparency, or maybe because of it shareholders continue to utilize the votes to communicate assert their views.

METHODOLOGY

For the 2006 survey of voting results, we compiled a database of 2,183 annual general and special meetings held between January 1 and June 30, 2006 covered by ISS and all the Report of Voting Results (Voting Reports) filed on SEDAR for these meetings between January and August 2006. Issuers at 839 of those meetings (38%) were successful in filing a report on voting results prior to September. While this figure appears

extremely low, it is identical to the filing rate from 2005 and we should note that NI51-102 does not require issuers listed on the Toronto Venture Exchange (TSX Venture) to file a Voting Report. TSX Venture-listed companies account for more than half of all the issuers in the ISS universe of Canadian companies and some voluntarily file Voting Reports. While these results suggest to shareholders that their franchise is not important or being taken seriously by issuers, closer inspection of the details contained in the Voting Reports show that shareholders are voicing their views loudly and issuers are becoming cognizant of appearing to dismiss shareholder concerns too lightly.

BACKGROUND

The Canadian Securities Administrators acknowledged the importance of disclosing voting results when it finally included a requirement to file voting reports in **National Instrument 51–102 – Continuous Disclosure Obligations**. The Instrument requires issuers to publish the results of all items voted on at shareholder meetings. While it was a commendable first step, the Instrument provides for great flexibility in the amount of details disclosed as well as no guidance on acceptable timeliness for the filing of reports. More specifically, the instrument allows;

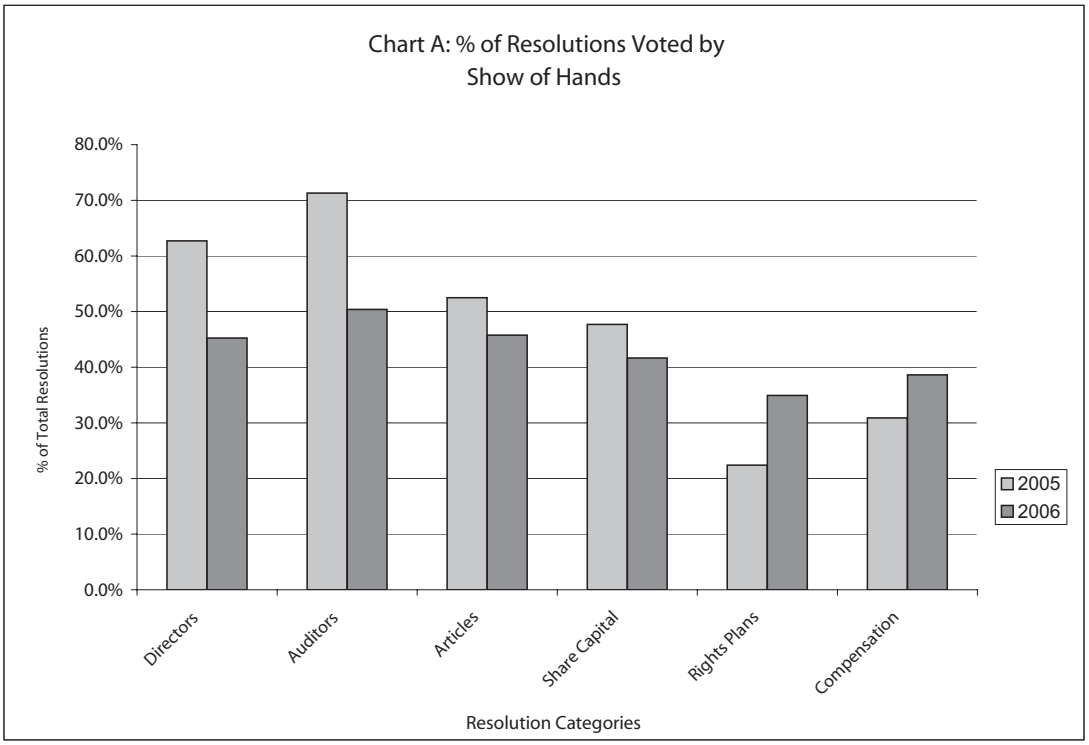
(1) vote tallies to be omitted when the vote is not conducted by a ballot; and

(2) percentages of votes cast rather than actual numbers of shares voted even when the vote is conducted by ballot.

This lack of a standardized disclosure requirements contributes to the large number of opaque filings that provide less than full disclosure, which can in the worst cases become misleading.

TIMELINESS: NEXT TO GODLINESS

The number of days between the annual meeting and the filing of Voting Reports has further declined in this the third year in which issuers have been required to file voting results. While the average number of days for all issuers dropped dramatically from the inaugural year – from 16.0 in 2004 to 9.2 days in 2005 – the decrease this year was significantly smaller. From the 2006 proxy season, all issuers took an average of 7.1 days to file results, with companies listed on the S&P TSX Composite Index (Index companies) taking an average of 5.7 days, and non-Index companies taking 7.3 days. While this year's improvement is small, it is encouraging nonetheless to see a substantial number of issuers, both Index and non-Index, able and willing to file voting reports within one day of holding their meetings.



SHOW OF HAND VOTING: CONVENIENCE VS TRANSPARENCY

On the other hand, we were disappointed to note from the provided disclosure that the number of agenda items being approved by a show of hands vote (SOH) increased in 2006 (Chart A). Both federal and provincial legislation permit SOH votes on ordinary resolutions,

usually under the conditions that votes submitted by proxy prior to the meeting illustrate that less than five percent of the votes cast oppose the resolution and a ballot can be requested by any shareholder present at the meeting. While this practice allows management to quickly and efficiently deal with the voting items on the agenda without the hassle of tabulating votes, it ignores issues of low voter turnout and abstained votes. Our survey shows that where SOH votes are taken very few, if any, issuers provide the details of the preliminary votes submitted. We have also found that the issuers providing basic disclosure per resolution are the same issuers neglecting to provide voter turnout data. These over-simplified Voting Reports are of little use to shareholders as they lack detail, transparency and accountability.

The SOH method of voting is visible at both annual and special meetings on all types of ordinary agenda items. The frequency of this method of voting cannot be blamed solely on the increased number of TSX Venture or non-Index companies, which tend to have very basic reporting practices when compared to the larger Index companies. Yet, our survey shows that Index and non-Index companies have increased SOH voting on compensation and shareholder rights plans and decreased SOH votes on board and other resolution categories. Rather it appears that the trend is largely due to the increasing number of smaller companies proposing these types of resolutions.

DETAILED VOTE TALLIES: MISSING IN ACTION OR TELLING TALES

With the percentage of issuers filing voting results reports remaining constant, and the percentage of issuers filing SOH vote results increasing, it is only logical that disclosure of specific vote tallies has deteriorated since 2005. Whereas voting on 16 percent of all 2005 agenda items was by SOH only, in 2006 the number increased to a whopping 46 percent. On first glance to be a particularly large jump, but we note that a large portion of this increase can be attributed to the increased number of issuers who now provide for individual director rather than single slate elections. In 2006 the number of director resolutions rose to over 3,100 up from 2,400 in 2005. While ISS believes that SOH voting on ordinary resolutions is an acceptable format for uncontested or routine agenda items, in the interests of full disclosure it would be laudable for companies to provide the vote tallies from the preliminary scrutineer's report showing that the voting items were indeed non-contentious. This type of information, as well as the votes represented is an urgent priority given that the number of shareholders voting by proxy greatly exceeds the number present in person at a meeting.

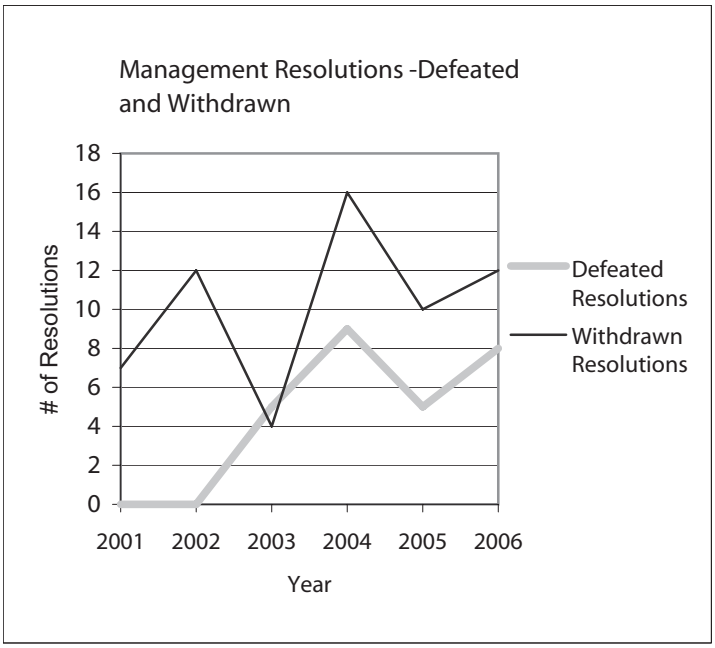
VOTER TURNOUT FALLING

Another improving trend is the increased disclosure of the total number or percentage of shares represented at the meeting. Whereas in 2005 only 30% of reports contained the data on shares represented at the meeting, 44% of reports did so in 2006. The average number of shares represented at meetings was down slightly, from 54% of total shares in 2005 to 53% in 2006. Given the non-contentious nature of this information we hope that more companies will continue volunteering this type of information.

MANAGEMENT ITEMS: DEFEATED AND WITHDRAWN

In the last five years the number of defeated management-proposed agenda items has risen steadily starting from zero in 2001. Shareholders in 2006 defeated a total of eight management resolutions. As the number of defeated proposals continues to increase we wonder if issuers will be forced to become even more reactive to shareholder concerns early on, rather than too late. Management at **Dexit Inc.** was blindsided when shareholders attended the meeting in person, united to oppose all five incumbent directors (see, "Dexit Inc. and Contested Meetings" in CGR Volume 18, Number 4, June/July 2006) who received support from less than a majority of the votes cast in person and by proxy. **Penn West Energy Trust** received the lowest support for any item when only 30% of shareholders voted For its proposed ExploreCo private placement, which incidentally ISS recommended voting Against. For a detailed look into the issues of discounted placements of ExploreCo shares see, "The Fruits of Conversion" in CGR Volume 18 Number 1, December/January 2006. A majority of shareholders also voted Against and defeated a stock option plan at **Cygnal**

Techonologies Corporation, and a 5:1 stock consolidation at **Meta Health Services Inc**. and **Synex International Inc.** While ISS recommended against the Cygnal option plan due



to excessive cost, we generally view stock consolidations as a routine business decisions. The Synex resolution required approval from three-quarters of the votes cast.

Rather than seeing a Management resolution go down to defeat, the case for withdrawing an agenda item can be particularly compelling for an issuer when early-returned proxy ballots tallied by transfer agents show very low support for the proposal. A total of 12 resolutions at nine separate meetings were withdrawn in 2006 by three Index companies and six non-Index companies. While the number of items withdrawn has remained in the single digit range, the type of items withdrawn has changed. In 2005 the more than half of the withdrawn items related to stock option plans. In contrast, in 2006 the withdrawn items were more evenly distributed among article resolutions, shareholder rights plans and director elections. ISS recommended voting 'Against' four of the 12 withdrawn items in 2006, including the following items: rights plans at **Crystallex International Corp.** and **Eldorado Gold Corp Ltd.**, article amendments at **First Asset Equal Weight Pipes & Power Income Fund**, and the creation of unlimited authorized capital at **Synex International Inc.**

AVERAGE SUPPORT FOR RESOLUTIONS

Where ballots were tallied to determine the outcome of resolutions, the level of shareholders support for management agenda items has decreased. The table below, shows resolutions on shareholder rights plans and equity compensation plans saw the biggest decrease in shareholder support. These two resolution categories were also responsible for the increase in SOH vote results (Chart A) and have the largest number of resolutions with less than 75 percent support per category. Taken together rights plans and compensation plans pose the highest risk for issuers. Rights plans in particular, show a propensity towards either a lukewarm or wholehearted reception from shareholders with very little balance in the middle. Together these facts underlie the reality that management resolutions that were once deemed routine and a foregone conclusion for shareholder approval, now have the potential to;

(1) become highly contentious if management is not proactive, and

(2) risk being defeated if management is not reactive to shareholder concerns.

Please note that the average votes For are calculated using the voting

Average Shareholder Support

Resolution Category	Total # Resolutions	Average % of Support for All Resolutions	Average % of Support for Index Resolutions	Average % of Support for Non-Index Resolutions
Directors & Boards	3,195	97.7%	97.9%	97.3%
Auditors	868	99.1%	99.1%	99.0%
Articles & By-Laws	198	95.1%	96.4%	93.5%
Share Capital	60	92.5%	98.0%	91.2%
Shareholder Rights Plans	63	82.8%	84.4%	81.8%
Equity Compensation	264	80.5%	81.9%	79.8%
Mergers & Acquisitions	72	96.9%	98.2%	96.4%
Shareholder Proposals	39	11.4%	9.8%	19.6%

results reports that include tallies; while reports with SOH results were excluded.

DIRECTORS

The director resolutions category encompasses all individual and slate director elections as well as resolutions fixing the size of boards. An overall high approval rating for director elections with average votes For directors reaching 97.7 percent is almost unchanged from 97.8 percent in 2005. Given the sheer volume of director elections both by slate and individually, this average is a somewhat misleading figure. Above is a list of all directors receiving approval from less than 75 percent of the votes cast.

Directors Receiving Less than Two-Thirds Support

Company Name	Director	ISS Rec	Votes For
Dexit Inc.	Gary Reinblatt	For	45.8%
Dexit Inc.	David R. Cox	For	45.9%
Dexit Inc.	Janet C. Martin	For	45.9%
Dexit Inc.	Bernard W. Crotty	For	46.0%
Dexit Inc.	Jeffrey S. Chisholm	For	48.0%
Duvernay Oil Corp.	Single Slate Election	Withhold	54.5%
SunOpta Inc.	Stephen Bronfman	Withhold	56.0%
Zaruma Resources Inc.	Frank van de Water	For	58.5%
Zaruma Resources Inc.	Michael Richings	For	58.5%
Zaruma Resources Inc.	Peter Lorange	Withhold	58.5%
Zaruma Resources Inc.	Thomas Utter	For	58.5%
Nexen Inc.	Victor Zaleschuck	Withhold	60.2%
Nexen Inc.	David Hentschel	Withhold	60.7%

The underlying reasons for ISS Withhold vote recommendations on the above list included; low attendance (two directors at 42 percent and 53 percent of board and committee meetings respectively), ex-CEO and ex-CFOs sitting on Audit and/or Compensation Committees, as well as insiders on Compensation Committees. In 2004, only three individual director elections and one slate election were approved by less than a two-thirds majority of the votes cast

Majority voting policies were voluntarily adopted at more than 25 Canadian companies. In line with their heads up view on this issue as well as other corporate governance best practices, it is not surprising that none of these companies was the target of a Withhold vote from ISS.

AUDITORS

The auditor category includes resolutions on the appointment and remuneration of external audit firms. Auditors garnered average support of 99.1 percent, up almost a full percentage point from 98.3 percent in 2005. **MDS Inc.** was a rare exception. Management's resolution to re-approve Ernst & Young LLP as the company's external audit firm was approved with just 69 percent of the votes cast. Scrutiny and skepticism of auditors in the post-Enron era may be easing. There was next to no difference between the average level of support at Index and non-Index companies. Twelve auditor resolutions were opposed by more than five percent of the votes cast (2005 – 17).

SHARE CAPITAL

This broad category of share capital resolutions combines resolutions such as; stock splits and consolidations, private placements, reductions to stated capital, conversion of share classes, ownership restrictions, and capital structure amendments such as approving unlimited capital authorizations. The vast majority of these resolutions are routine in nature and not generally opposed by ISS. **Four Seasons Hotel Inc.** put their unique dual class capital share structure consisting of Limited Voting and Variable Multiple Voting Shares in front of shareholders for their reapproval. The resolution was determined by a very close ballot with 51.8 percent of the votes cast supporting the resolution. While the company noted the total number of votes cast For and Against the resolution, it did not disclose a breakdown of the votes cast as cast by the Limited (entitled to one vote per share) and Variable Multiple Voting Shares (entitled to 16.15 votes per share).

SHAREHOLDER RIGHTS PLANS

Shareholders continue to question rights plans as a safeguard in the battle for control of companies, especially those in the booming energy sector. Compared to the consensual voting for directors, voting for rights plans is less certain with average support at 83% in 2006. Of the companies providing a vote tally, ISS supported 22 rights plans which went on to receive average shareholder support form 85.4 percent of the votes cast. Support fell to 78.5 percent for the 15 plans that ISS did not support, as they could not be considered 'next generation'. **Spinrite Income Fund** proposed a new unitholder rights plan for shareholder approval at their annual general meeting. While ISS found most of the terms and provisions of the Spinrite plan to conform to 'new generation' guidelines for Canadian rights plans, the plan deviated in one significant aspect, in that it did not permit partial bids. In our initial report, ISS recommended shareholders vote Against the plan. We issued an alert and updated our vote recommendation, a day later and two weeks prior to the voting deadline, after the fund filed an amendment to its original rights plan to the effect of permitting partial bids. After receiving votes from almost half of the issued and outstanding shares, even as a 'new generation' rights plan, the resolution received support from only 51.9 percent of the votes cast. Requiring a simple majority of votes cast to be approved, the resolution just barely squeaked through. However, in their Report of Voting results, the fund noted that it, "did not wish to act in a manner not supported by its unitholders". The board therefore withdrew the resolution and the fund was deemed to have elected to have redeemed the rights at the redemption price of $0.00001 per right.

COMPENSATION

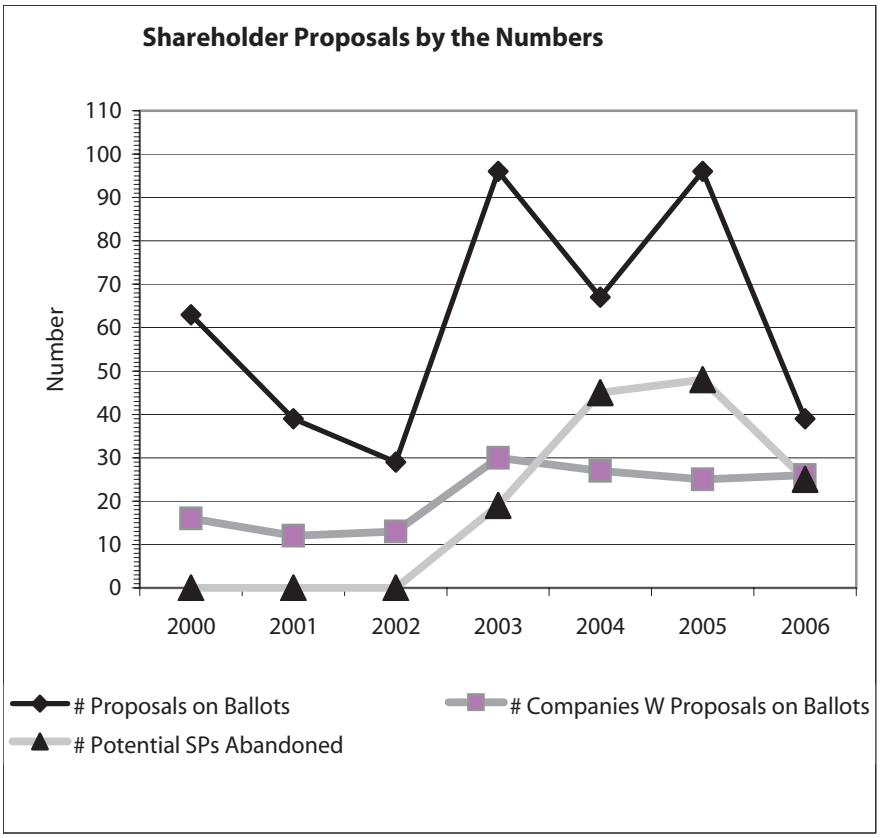
Shareholders continue to be increasingly critical of executive compensation plans. Average shareholder support for equity compensation plans continues to be the lowest of all types of agenda items with average support down slightly from 82% in 2005 to 81% in 2006. The following is a list of companies proposing equity-based compensation resolutions that subsequently received approval from less than two-thirds of the votes cast.

Companies with Equity-Based Compensation Plans Receiving Less Than Two-Thirds Support

Company	ISS Vote Rec	Votes For
Aastra Technologies Ltd.	Against	55.5%
AMVESCAP Inc.	Against	51.6%
Aspreva Pharmaceuticals Corp.	Against	60.3%
Bema Gold Corporation	For	65.0%
Breakwater Resources Ltd.	Against	57.0%
Cardiome Pharma Corp.	Against	57.6%
Centurion Energy International Inc	Against	53.2%
Cervus Financial Group Inc.	For	54.2%
Cygnal Technologies Corporation	Against	42.5%
Enterra Energy Trust	Against	64.4%
Environmental Management Solutions Inc.	Against	61.1%
Equinox Minerals Ltd.	Against	55.5%
Global Railway Industries Ltd.	Against	50.3%
Gold Reserve Inc.	Against	60.7%
Hillsborough Resources Ltd.	Against	59.9%
Hub International Inc.	Against	64.6%
KCP Income Fund	For	61.4%
Penn West Energy Trust	For	66.1%
Petrobank Energy & Resources	Against	63.4%
Real Resources Ltd.	For	64.2%
Redcorp Ventures Ltd.	Against	56.4%
Rutter Inc.	Against	55.7%
Spectrum Signal Processing Inc.	Against	47.1%
Synenco Energy Inc.	For	62.5%
TLC Vision Corporation	For	63.4%
Xillix Technologies Corp.	Against	51.6%

SHAREHOLDER PROPOSALS

While issuers are still adjusting to the need to address shareholder concerns regarding their own management proposals, those targeted with shareholder proposals have already become more accommodating with these concerned shareholders. Together with more proposals withdrawn prior to their inclusion on proxy ballots, it appears management is becoming more open to incorporating other stakeholder



concerns into their decision-making process. In 2006, the number of shareholder proposed resolutions appearing on meeting agendas decreased while the average support has increased. After reaching a high of 95 in 2005 (also reached in 2003) the total number of shareholder proposals fell to 39 at 19 meetings in 2006. In 2006 shareholders more than doubled average support for their proposals from 5.4% in 2006 to 11.4% in 2006.

Abitibi Consolidated Inc.'s shareholder resolution requesting individual director elections, won support from 70 percent of the votes cast, partly explaining the jump in average support and counting as the only shareholder proposal to be approved in 2006. Given that activist shareholders, along with ISS, have long advocated for individual director elections, the majority support for this proposal is unsurprising. Rather, it is striking that given the shift toward greater director accountability, the board chose to put this proposal to a vote rather than adopting it voluntarily.

Just as management-proposed agenda items with less than 75% support are unusual in Canada, so too are shareholder-proposed agenda items with greater than 5% support. Proposals to prepare human rights reports on China and Tibet won an eye-popping percentage of 'For' votes at **Power Corporation of Canada** (10%), **Nortel Networks Corporation** (36%) and **Bombardier Inc.** (10%). Another shareholder proposal relating to human rights and winning unusually high support (38%) was the proposal at **Alcan Inc.** to prepare a report on the social impact of its operations in Kashipur India. Since ISS recognizes the value of labour standards and formal company policies on human rights practices, particularly for companies that have operations or substantial investments in countries where there are fewer protections for workers and human rights, we recommended shareholders vote 'For' these shareholder proposals.

PROXY CONTESTS

Extreme concerned shareholders go beyond shareholder proposals, instead launching proxy fights for control of the issuer's board. It is difficult to report on voting results at proxy contests as management and dissidents are often able to negotiate compromises prior to going to a vote. Three recent proxy contests at **Gallery Resources Ltd., Vanguard Investments Corp.**, and **MOSAID Technologies Incorporated,** discussed later in this issue in the Company News Briefs section illustrate this fact. In the case of **WEX Pharmaceuticals Inc.** the company postponed their AGM upon receipt of a dissident circular which proposed an alternate slate of directors and recommended shareholders vote against a shareholder proposal to create a royalty trust and an amendment of outstanding warrant terms. The company gained the support of the "dis-satisfied shareholders", which included members of the company's own Advisory Board, after management provided additional information and consulted with them on several amendments made to the proposals in contention. The modified slate of directors and warrant amendment resolutions were approved by a show of hands and 90 percent of votes cast, respectively. The resolution to convert to a royalty trust was not put to a vote at the postponed meeting. Depending on which side you were on, and what your final goal

was, proxy contests of varying success were also waged at the following companies:

Algoma Steel Inc.
Condor Gold Corp.
Tiverton Petroleums Ltd.
Zaruma Resources Inc.

CONCLUSION

Disclosure of Voting Reports continues to be far from complete. Most often the percentage of shares represented at the meeting is the key information missing. However also prominent are Voting Reports that disclose; only show of hand approved resolutions without a tally of proxy ballot votes, or resolutions approved by ballot with percentages but missing the number proxy votes For, Against and Abstained. ISS has long upheld that complete disclosure of voting results at annual meetings is an important part of the shareholder's franchise and without it shareholders cannot be assured that their votes have been counted and contributed to the outcome of decisions made at annual meetings.

As the third year of required disclosure of vote results parades by, we continue to see many issuers still providing the most basic and rudimentary levels of disclosure. As the regulators begin reviewing other Instruments put in place to build investor confidence we can only hope that a review and possible amendment of the continuous disclosure obligations contained in Part 11 of NI51-102 is also in the near future. As Venture issuers are no less likely to experience concern from shareholders, removing their current exemption from the vote reporting process would increase their sense of accountability to shareholders.

We applaud all issuers who are able to file voting reports within a week of their meetings and who take the time to carefully tabulate and report on all the votes submitted to meetings in person as well as by proxy. The disclosure of voter turnout is the final piece of the puzzle, allowing each shareholder to gauge for themselves whether or not they are part of or isolated from the masses. In lieu of more useful continuous disclosure obligations we put our trust in the hands of issuers to realize the importance of making proxy voting a circular process of communication rather than just the giving and taking of ballots.

Company News Briefs

Pill Update

The following new shareholder rights plans were adopted for approval at shareholder meetings scheduled during the months of August and September 2006:

International Wayside Gold Mine
Chariot Resources Ltd.
Bronco Energy Ltd.
Mountain Province Diamonds Inc.
Mega Uranium Ltd.
Keegan Resources Inc.
Pacific Rim Mining

As well, there were four proposals to reconfirm or approve amended rights plans at the following companies:
Rubincon Minerals Corporation
Mediagrif Interactive
Certicom Corp.
Westbond Enteprises Corp.

Re-filings and Errors List

The following companies were added to the Ontario Securities Commissions' Re-filings and Errors List over the last two months:

Allied Properties Real Estate Income Trust
Aquila Resources Inc.
Atlas Cold Storage Income Trust
Bioniche Life Sciences Inc.
Blue Pearl Mining Ltd.
Certicom Corp.
DVD Investments Limited
Echo Energy Canada Inc.
E.G. Capital Inc.
E-L Financial Corporation Ltd.
Emblem Capital Inc.
Family Memorials Inc.
First Nickel Inc.
The Goldfarb Corporation
H&R Real Estate Investment Trust

Lexam Explorations Inc.
Lorus Therapeutics Inc.
Medoro Resources Ltd.
MedX Health Corp.
Microbix Biosystems Inc.
North Atlantic Resources Ltd.
OutdoorPartner Media Corporation
RoaDor Industries Ltd.
Rtica Corporation
Tiomin Resources Inc.
TLC Vision Corporation
Wesdome Gold Mines Ltd.

Majority Vote Adoptions Update

Ending a long late summer drought, **Cognos Inc.** kicked off the fall season, disclosing the adoption of a majority voting policy on the election of directors in their recent circular. The Cognos policy included a provision not often seen in previous Canadian policies whereby if fewer than three independent directors receive the support of a majority of the votes cast then all directors may participate in the decision on whether or not to accept the tendered resignations.

Proxy Contests Camouflaged

In recent months three companies have found themselves the target of concerned shareholders. A special meeting was convened on August 14, 2006, by **Gallery Resources Ltd.** shareholders after the company failed to respond to their earlier request in December 2005 to call a shareholder meeting to remove an incumbent director and elect one or more new directors. Gallery is currently under investigation from the British Columbia Securities Commission and the company's shares were de-listed from the Toronto Venture Exchange in January 2006.

The dissidents filed an information circular and proxy ballot proposing a resolution to remove the three incumbent directors and elect three of their own nominees. While the dissidents did state that upon election, they would source appropriate personnel to be retained as President and as Chief Financial Officer to over see the company's affairs and work with the Toronto Stock Exchange and the British Columbia Securities Commission regarding past accounting issues and the possibility of re-establishing a listing for the company's shares, they did not provide any contact information, background history or explanation for their proposal. Gallery management did not file a public response to the concerned shareholders and did not return ISS phone calls prior to the meeting. Given the lack of information available from either side, ISS did feel there was sufficient information to support this resolution.

The Gallery dissidents held just 0.026 percent of the company's outstanding shares as of the record date. Notwithstanding this, over 60 percent of the outstanding shares were represented at the meeting, and the resolution went on to garner the support of 77 percent of the votes cast. Since being elected, the new board has appointed the company's former CFO, Karl S. Basi as the new Chief Operating Officer and is also seeking legal advice to rescind recent share awards granted to former employees and consultants of the company.

In another more recent one-sided battle, concerned shareholders of **Vanguard Investments Corp.** called a special meeting for October 6, 2006, following that company's failure to call a meeting within 21 days of the shareholders requisitioning a meeting. After filing a prospectus in August 2001 as a Capital Pool Company, the company was de-listed from the Toronto Venture Stock Exchange in July 2004 when it failed to complete a Qualifying Transaction. The company does not appear to have ever held a shareholders' meeting. Again the dissidents provided very little explanation for their proposals to remove the incumbent directors and elect their own nominees, other than to state that upon being elected they intended to take immediate steps to rectify any deficient filings and seek opportunities to adequate capitalize the corporation and establish a business. Vanguard management did not file a public response to the concerned shareholders and was not able to provide ISS with any coherent answers. Given the lack of information available from either side, ISS did feel there was sufficient information to support this resolution. The Vanguard dissidents are believed to hold 19 percent of the outstanding shares, which easily meets the company's quorum requirement of two persons representing in person or by proxy at least five percent of the outstanding shares.

Finally two sides made it to the battlefield well prepared to duke it out for **MOSAID Technologies Incorporated** only to reach a settlement agreement prior to the vote. After calling an AGM for September, MOSAID received and responded to a letter from hedge fund Loeb Partners Corporation, stating they would, if necessary, "engage in a proxy contest to confirm the support of our shareholders". Just two weeks prior to the meeting date, Loeb filed a dissident proxy circular and ballot, proposing to replace three of the independent incumbent directors with three of its own nominees.

After numerous meetings with both management and the dissidents, ISS expected the potential for two different scenarios unfolding for the company. If the dissidents were to win, the new board would be driven to effect major changes to unlock value in the near term, with the process culminating in the sale of the company. While we believed that the incumbents would be more concerned with the company as a going concern, seeking to build value over the long-term through maximization alternatives, with the dissident's pressure accelerating the pace of change. If elected the three dissident directors would represent a minority of the seven directors, however through the replacement of independent nominees of the incumbent board, they would control the key committees of the board. By taking control of the committees and thus control of the recommendations made to the board, the dissidents would assume a much more powerful position than their minority position would suggest. On the other hand, four of seven directors would still be incumbent directors, and with three representing management, board decisions begin to look particularly challenging especially following a proxy contest. In the end, ISS decided to support the incumbent board as the better choice for shareholders over the long term.

Directly and indirectly through various funds, Loeb owns 9.1 percent of the outstanding MOSAID shares. The company held out until just prior to the AGM, before coming to agreement with Loeb, which saw the board expanded to ten members allowing for the election of all seven incumbent and three dissident nominees. The agreement also specified that Thomas Csathy will remained as Chairman of the board, and the Special Committee of the board responsible for conducting the review of strategic alternatives, will be comprised of two directors from the MOSAID slate, and two from the Loeb slate, with the committee Chairman being Eugene Davis. The agreement further, allows Loeb to designate replacements if any of the Loeb nominees are unable or unwilling to serve as a director, and prohibits Loeb from launching a hostile take-over bid within six months. With the agreement in place all ten nominees were declared elected as directors.

ISS
INSTITUTIONAL SHAREHOLDER SERVICES

Corporate Governance Review

Publisher: Institutional Shareholder Services Canada Corp.

Editor: Michelle Tan
Contributors: Bill Mackenzie
Julie Scott
Debra Sisti
Michelle Tan

ISSN 1203-2999
The Review is published six times per year
Subscriptions are available for $295 per year.
Call 416.364.9000 or
visit www.issproxy.com for information