



An MSCI Brand

2012 Canadian Proxy Voting Guidelines
Venture Companies

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Institutional Shareholder Services Inc.

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ISS' 2012 Canadian Proxy Voting Guidelines- Venture Companies

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INTRODUCTION

The primary purpose of a public corporation is to create sustainable value for its shareowners. To that end, ISS designs its proxy voting guidelines to enhance shareholders' long-term economic interests. ISS' Benchmark proxy voting guidelines serve as a tool to assist institutional investors in meeting their fiduciary requirements with respect to voting by promoting shareholder value creation and risk mitigation at their portfolio firms.

ISS reviews and updates its proxy voting guidelines each year, taking into account emerging issues and trends, the evolution of market standards, regulatory changes, and feedback provided by ISS' institutional clients.

ISS' robust and transparent [policy formulation process](#) includes an exhaustive review of relevant empirical studies and other factual data, an annual [policy survey](#) of institutional clients and corporate issuers, policy roundtables with a wide range of industry constituents, and an open [comment period](#) on draft policy changes. ISS also conducts internal research to validate assumptions and policy positions.

The Benchmark Policy Guidelines consider market-specific recommended best practices, transparency, and disclosure when addressing issues such as board structure, director accountability, corporate governance standards, executive compensation, shareholder rights, corporate transactions, and social/environmental issues.

ISS' policy guidelines require the consideration of company-specific circumstances. When issuing a vote recommendation on a proposal, ISS considers historical operating and investment performance, company disclosure (and proponent/dissident disclosure, if applicable), the company's governance structure and historical practices, and its industry.

In applying these policies, ISS often engages with public issuers, shareholders, activists, and other stakeholders to seek additional information and to gain insight and context in order to provide our clients with informed vote recommendations. This engagement process enhances dialogue and promotes a higher level of understanding between investors and the companies in which they invest.

In formulating proxy voting policies, ISS assesses the potential costs and benefits of the adoption or rejection of the underlying ballot items. Where the economic impact of a ballot item is not apparent and may involve trade-offs, the guidelines direct analysts to consider the economic consequences as well as potential risks to shareholders of approval.

This document presents ISS' Benchmark Canadian Corporate Governance Policies for Venture companies. The document, along with other policy documents, is available on our Web site under the [Policy Gateway](#). If you have any questions, please contact ca-research@issgovernance.com.

These policies will be effective for meetings on or after Feb. 1, 2012.



1. Routine/Miscellaneous

Audit-Related

Financial Statements/Director and Auditor Reports

Companies are required under the CBCA to submit their financial statements and the auditor report, which is included in the company's annual report, to shareholders at every AGM. This item is almost always non-voting.



Ratification of Auditors

Generally vote for proposals to ratify auditors EXCEPT where:

- Non-audit related fees paid to the auditor exceed audit-related fees.

RATIONALE: Multilateral Instrument 52-110 relating to Audit Committees defines “audit services” to include the professional services rendered by the issuer’s external auditor for the audit and review of the issuer’s financial statements or services that are normally provided by the external auditor in connection with statutory and regulatory filings or engagements.

Audit services include tax preparation and filing fees. Fees disclosed as “Other” that are paid only for the preparation of regulatory filings in conjunction with initial public offerings, emergence from bankruptcy and spin-offs, will now be excluded from the calculation for determining whether non-audit fees exceed audit and audit related fees paid to the external audit firm as long as detailed disclosure is provided to shareholders which identifies the nature of these fees. This change recognizes the exceptional one-time nature of these three specific corporate reorganization type fees which can be substantial and can therefore affect the results of the audit versus non-audit fee comparison.

In all Canadian jurisdictions except British Columbia, in conjunction with Multilateral Instrument 52-110 Audit Committees, Form 52-110F2 Disclosure for Venture Issuers requires that venture companies disclose:

- The text of the audit committee’s charter;
- The name of each audit committee member and state whether or not that member is (i) independent and (ii) financially literate;
- A description of any policies or procedures adopted by the audit committee for the engagement of non-audit services;
- All fees paid to the external audit firm, broken down by category as (i) Audit Fees, (ii) Audit-Related Fees, (iii) Tax Fees, or (iv) Other Fees.

If a venture issuer does not solicit proxies from security holders, then the required disclosure must appear in its Annual Information Form or annual MD&A.

For BC incorporated issuers, BC Instrument 52-509 Audit Committees requires substantially similar compliance except that certain committee and disclosure requirements do not apply to any reporting issuer if the board of directors consists of fewer than five directors and the board performs specified requirements of the audit committee, including taking reasonable steps to ensure that the external audit firm is independent; ensuring that the fees charged by the external auditor for audit-related work are appropriate; determining the audit engagement terms by which the auditor formally

reports to the issuer; monitoring the audit process and management’s role and any disagreements that might arise between auditor and management; establishing and monitoring policies governing the external auditor firm’s provision of non-audit services and the issuer’s hiring of persons formerly employed by the audit firm; and, annually preparing a report to shareholders describing steps taken to ensure auditor independence, policies and procedures implemented to ensure contracts for non-audit services do not compromise auditor independence, and the nature of any non-audit service contracts with the auditor and the amount of fees charged for such services.



Other Business

Generally vote AGAINST all proposals on proxy ballots seeking approval for unspecified “other business” that may be conducted at the shareholder meeting.



2. Board of Directors

Slate Ballots (Bundled director elections)

According to research conducted by ISS, the prevalence of slate ballots at TSX companies declined significantly over the past year. An increasing number of venture companies are also providing individual director elections. Although ISS has not yet implemented a similar Slate Ballot policy for TSX Venture issuers, the continued use of slate ballots denies shareholders the ability to register disapproval for individual director nominees and has resulted in ISS withhold recommendations from entire slates in order to register such disapproval.



Voting on Director Nominees in Uncontested Elections

The following fundamental principles apply when determining votes on director nominees:

Board Accountability: Practices that promote accountability and enhance shareholder trust begin with transparency into a company's governance practices including risk management practices. These practices include the annual election of all directors by a majority of votes cast by all shareholders and provide shareholders with the ability to remove problematic directors, and include the detailed timely disclosure of voting results. Board accountability is facilitated through clearly defined board roles and responsibilities, regular peer performance review, and shareholder engagement.

Board Responsiveness: In addition to facilitating constructive shareholder engagement, boards of directors should be responsive to the wishes of shareholders as indicated by majority supported shareholder proposals or lack of majority support for management proposals including election of directors. In the case of a company controlled through a dual-class share structure, the support of a majority of the minority shareholders should equate to majority support.

Board Independence: Independent oversight of management is a primary responsibility of the board and while true independence of thought and deed is difficult to assess, there are corporate governance practices with regard to board structure and management of conflicts of interest that are meant to promote independent oversight. Such practices include the selection of an independent chair to lead the board; structuring board pay practices to eliminate the potential for self-dealing, reduce risky decision-making and ensure the alignment of director interests with those of shareholders rather than management; structure separate independent key committees with defined mandates. Complete disclosure of all conflicts of interest and how they are managed is a critical indicator of independent oversight.

Board Capability: The skills, experience, and competencies of board members should be a priority in director selection, but consideration should also be given to a board candidate's ability to devote sufficient time and commitment to the increasing responsibilities of a public company director. Directors who are unable to attend board and committee meetings and/or who are overextended (i.e., serving on too many boards) raise concern regarding the director's ability to effectively serve in shareholders' best interests.



ISS Canadian Definition of Independence

Inside Director (I)

- Employees of the Company or its affiliates¹;
- Non-employee officer of the Company if he/she is among the five most highly compensated;
- Current interim CEO;
- Beneficial owner of Company shares with more than 50% of the outstanding voting rights.

Affiliated Outside Director (AO)

- Former executive with the Company within the last three years (excluding CEO);
- Former CEO (no cooling off period);
- Former interim CEO if the service was longer than 18 months or if the service was between 12 and 18 months and the compensation was high relative to that of the other directors (5x their pay) or in line with a CEO's compensation²;
- Former executive of the Company, an affiliate or a firm acquired within the past three years;
- Executive of a former parent or predecessor firm at the time the Company was sold or split off from parent/predecessor (subject to three year cooling off other than CEO);
- Executive, former executive with last three years, general or limited partner of a joint venture or partnership with the Company;
- Relative³ of current executive officer⁴ of the Company;
- Relative of a person who has served as an executive officer of the Company within the last three years;
- Currently provides (or a relative provides) professional services to the Company or to its officers;
- Currently employed by (or a relative is employed by) a significant customer or supplier⁵;
- Is (or a relative is) a trustee, director or employee of a charitable or non-profit organization that receives grants or endowments from the Company;
- Has (or a relative has) a transactional relationship with the Company excluding investments in the Company through a private placement;
- Has a contractual/guaranteed board seat and is party to a voting agreement to vote in line with management on proposals being brought to shareholders;
- Founder⁶ of the Company but not currently an employee;
- Board attestation that an outside director is not independent.

Independent Directors (IO)

- No material⁷ ties to the corporation other than board seat.

¹ "Affiliate" includes a subsidiary, sibling company, or parent company. ISS uses 50 percent control ownership by the parent company as the standard for applying its affiliate designation.

² ISS will look at the terms of the interim CEO's compensation or employment contract to determine if it contains severance pay, long-term health and pension benefits or other such standard provisions typically contained in contracts of permanent, non-temporary CEOs. ISS will also consider if a formal search process was underway for a full-time CEO.

³ Relative refers to immediate family members including spouse, parents, children, siblings, in-laws and anyone sharing the director's home.

⁴ Based on the definition of Executive Officer used in Multilateral Instrument 52-110.

⁵ If the company makes or receives annual payments exceeding the greater of \$200,000 or 5 percent of recipient's gross revenues (the recipient is the party receiving proceeds from the transaction).

⁶ The operating involvement of the Founder with the company will be considered. Little or no operating involvement may cause ISS to deem the Founder as an independent outsider.

⁷ "Material" is defined as a standard of relationship (financial, personal or otherwise) that a reasonable person might conclude could potentially influence one's objectivity in the boardroom in a manner that would have a meaningful impact on an individual's ability to satisfy requisite fiduciary standards on behalf of shareholders.

Vote CASE-BY-CASE on director nominees, examining the following factors when disclosed:

- Independence of the board and key board committees;
- Attendance at board, and if disclosed, committee meetings;
- Corporate governance provisions and takeover activity;
- Long-term company performance;
- Director's ownership stake in the company;
- Compensation practices;
- Responsiveness to shareholder proposals;
- Board accountability;
- Adoption of a Majority Voting (director resignation) policy.

RATIONALE: Corporate Governance disclosure requirements for Venture Issuers are set out in CSA Form 58-101F2.

Disclosure for boards of directors includes:

- Assessment of the independence of each director and the basis for determination;
- Identification of any other issuer for which the director holds a board seat;
- Description of the director orientation process, if any, and continuing education measures;
- Description of ethical business conduct policies or procedures;
- Disclosure of the nomination process and who is responsible for identifying new candidates;
- Disclosure of the process for determining executive compensation and who is responsible;
- Description of standing board committees other than the audit, compensation and nominating committees;
- Description of any board assessment procedures.

Insiders on Key Committees

Generally vote WITHHOLD from individual directors (and the whole slate if the slate includes such individual directors) who:

- Are insiders on the Audit Committee.

Generally vote WITHHOLD from individual directors (and the whole slate if the slate includes such individual directors) who:

- Are insiders on the Compensation Committee or the Nominating Committee and the Committee is not majority independent.

Generally vote WITHHOLD from individual directors who:

- Are insiders (and the whole slate if the slate includes such individual directors) and the entire board fulfills the role of a compensation committee or a nominating committee and the board is not majority independent.

RATIONALE: Given the limitations presented by extremely small boards of directors at many Canadian venture issuers, ISS believes that flexibility may be extended to these companies to permit an insider on the Compensation Committee (or Nominating Committee if there is one) as long as the committee is majority independent and thus provides an effective balance of independent directors to ensure an independent perspective to counterbalance the presence of an insider. The same rationale would apply to the board as a whole if the entire board fulfills the role of the Compensation Committee or Nominating Committee.

Meeting Attendance

Meeting attendance disclosure is not required for venture issuers, therefore no policy is contemplated in this area.

Audit Fee Disclosure

Generally vote WITHHOLD from individual directors who are members of the Audit Committee as reported in the most recently filed public documents if:

- No audit fee information is disclosed by the Company within a reasonable period of time prior to a shareholders' meeting at which ratification of auditors is a voting item.

RATIONALE: In addition to audit fee disclosure by category being a regulatory requirement, such information is of great importance because of the concern that audit firms could compromise the independence of a company audit in order to secure lucrative consulting services from the company.

Excessive Non-Audit Fees

Generally WITHHOLD votes from individual directors (and the whole slate if the slate includes such individual directors) who are members of the Audit Committee as constituted in the most recently completed fiscal year if:

- Non-audit fees (Other Fees) paid to the external audit firm exceeds audit and audit-related fees.

RATIONALE: Part 2 of Multilateral Instrument 52-110 Audit Committees states that the audit committee must be directly responsible for overseeing the work of the external auditor and the audit committee must pre-approve all non-audit services provided to the issuer or its subsidiary entities by the issuer's external auditor. It is therefore appropriate to hold the audit committee accountable for payment of excessive non-audit fees.

Voting on Directors for Egregious Actions

Under extraordinary circumstances, vote WITHHOLD from directors individually, one or more committee members, or the entire board, due to:

- Material failures of governance, stewardship, risk oversight or fiduciary responsibilities at the company;
- Failure to replace management as appropriate; or
- Egregious actions related to the director(s)' service on other boards that raise substantial doubt about his or her ability to effectively oversee management and serve the best interests of shareholders at any company.

RATIONALE: Director accountability and competence have become issues of prime importance given the failings in oversight exposed by the global financial crisis. There is also concern over the environment in the boardrooms of certain markets, where past failures appear to be no impediment to continued or new appointments at major companies and may not be part of the evaluation process at companies in considering whether an individual is, or continues to be, fit for the role and best able to serve shareholders' interests.

Under exceptional circumstances that raise substantial doubt on a director's ability to serve as an effective monitor of management and in the best interests of shareholders including past performance on other boards, we may consider a negative recommendation on directors.



Other Board-Related Proposals

Classification/Declassification of the Board

Vote AGAINST proposals to classify the board.

Vote FOR proposals to repeal classified boards and to elect all directors annually.



Independent Chairman (Separate Chairman/CEO)

Generally vote FOR shareholder proposals seeking separation of the offices of CEO and Chair if:

- The company has a single executive occupying this position
- The board does not have a majority independent board.

RATIONALE: We support the separation of the positions of Chair and CEO and view it as superior to the lead director concept because of the inherent conflicts that arise if the same person is the leader of the board of directors, which is responsible for selecting and replacing the CEO, setting executive pay, evaluating managerial and company performance, and representing shareholder interests; and the CEO, who by contrast, is responsible for maintaining the day to day operations of the company and being the company's spokesperson. It therefore follows that one person cannot fulfill both roles without conflict. However, one person typically fulfills both roles at venture issuers due, again, to the limited resources and extremely small boards. As noted previously, we believe flexibility is necessary for these small issuers but expect at a minimum that the board of directors be comprised of a majority of independent directors in order to provide the requisite independent balance to board oversight.



Majority Vote Standard for the Election of Directors

Vote FOR resolutions requesting that: (i) the board adopt a majority vote standard and director resignation policy for director elections or (ii) the company amend its bylaws to provide for majority voting, whereby director nominees are elected by the affirmative vote of the majority of votes cast, unless:

- A majority voting policy is codified in the company's bylaws, corporate governance guidelines, or other governing documents prior to an election to be considered, and;
- The company has adopted formal corporate governance principles that provide an adequate response to both new nominees as well as "holdover" nominees (i.e. incumbent nominees who fail to receive 50% of votes cast).



Proxy Contests - Voting for Director Nominees in Contested Elections

Generally vote CASE-BY-CASE in contested elections taking into account:

- Long-term financial performance;
- Board performance;
- Management's track record and compensation;
- Qualifications of director nominees (both slates); and
- Evaluation of what each side is offering shareholders.

Overall Approach

When analyzing proxy contests, ISS focuses on two central questions:

1. Have the dissidents met the burden of proving that board change is warranted? And, if so;
2. Will the dissident nominees be more likely to affect positive change (i.e., increase shareholder value) versus the incumbent nominees?

When a dissident seeks a majority of board seats, ISS will require from the dissident a well-reasoned and detailed business plan, including the dissident's strategic initiatives, a transition plan and the identification of a qualified and credible new management team. ISS will then compare the detailed dissident plan against the incumbent plan and the dissident director nominees and management team against the incumbent team in order to arrive at our vote recommendation.

When a dissident seeks a minority of board seats, the burden of proof imposed on the dissident is lower. In such cases, ISS will not require from the dissident a detailed plan of action, nor is the dissident required to prove that its plan is preferable to the incumbent plan. Instead, the dissident will be required to prove that board change is preferable to the status quo and that the dissident director slate will add value to board deliberations including by, among other factors, considering issues from a different viewpoint than the current board members.

Reimbursing Proxy Solicitation Expenses

Vote CASE-BY-CASE taking into account:

Whether ISS recommends in favour of the dissidents, in which case we may recommend approving the dissident's out of pocket expenses if they are successfully elected and the expenses are reasonable.



3. Shareholder Rights & Defenses

Supermajority Vote Requirements

Generally vote AGAINST proposals to require a supermajority shareholder vote at a level above that required by statute.

Generally vote FOR proposals to lower supermajority vote requirements.



Cumulative Voting

We support cumulative voting, on balance. However there may be situations where such a structure may be detrimental to shareholder interests.

Generally vote against proposals to eliminate cumulative voting.

Generally vote FOR proposals to restore or permit cumulative voting but exceptions may be made depending on the company's other governance provisions such as the adoption of a majority vote standard for the election of directors.



Confidential Voting

Generally vote FOR shareholder proposals requesting that corporations adopt confidential voting, use independent vote tabulators and use independent inspectors of election, as long as:

- The proposal includes a provision for proxy contests as follows: In the case of a contested election, management should be permitted to request that the dissident group honor its confidential voting policy. If the dissidents agree, the policy remains in place. If the dissidents will not agree, the confidential voting policy is waived for that particular vote.

Generally vote FOR management proposals to adopt confidential voting.



Appointment of Additional Directors Between Annual Meetings

Generally vote FOR these resolutions where:

- The company is incorporated under a statute (such as the CBCA) that permits removal of directors by simple majority vote;
- The number of directors to be appointed between meetings does not exceed one-third of the number of directors appointed at the previous annual meeting; and
- Such appointments must be approved by shareholders at the annual meeting immediately following the date of their appointment.



Poison Pills (Shareholder Rights Plans)

Vote CASE-BY-CASE on management proposals to ratify a shareholder rights plan (poison pill) taking into account whether it conforms to ‘new generation’ rights plans and its scope is limited to the following two specific purposes:

- To give the board more time to find an alternative value enhancing transaction; and
- To ensure the equal treatment of all shareholders.

Vote AGAINST plans that go beyond these purposes if:

- The plan gives discretion to the board to either:
 - Determine whether actions by shareholders constitute a change in control;
 - Amend material provisions without shareholder approval;
 - Interpret other provisions;
 - Redeem the rights or waive the plan’s application without a shareholder vote; or
 - Prevent a bid from going to shareholders.
- The plan has any of the following characteristics:
 - Unacceptable key definitions;
 - Reference to Derivatives Contracts within the definition of Beneficial Owner;
 - Flip over provision;
 - Permitted bid period greater than 60 days;
 - Maximum triggering threshold set at less than 20% of outstanding shares;
 - Does not permit partial bids;
 - Includes a Shareholder Endorsed Insider Bid (SEIB) provision;
 - Bidder must frequently update holdings;
 - Requirement for a shareholder meeting to approve a bid; and
 - Requirement that the bidder provide evidence of financing.
- The plan does not:
 - Include an exemption for a “permitted lock up agreement”;
 - Include clear exemptions for money managers, pension funds, mutual funds, trustees and custodians who are not making a takeover bid; and
 - Exclude reference to voting agreements among shareholders.

RATIONALE: The evolution of “new generation” shareholder rights plans in Canada has been the result of reshaping the early anti-takeover provision known as a “poison pill” into a shareholder protection rights plan that serves only two legitimate purposes: (i) to increase the time period during which a Permitted Bid may remain outstanding to a maximum of 60 days in order to give the board of directors of a target company sufficient time over and above the current statutory 35 day limit, to find an alternative to a takeover bid that would increase shareholder value; and (ii) to ensure that all shareholders are treated equally in the event of a bid for their company.

Elimination of board discretion to interpret the key elements of the plan was critical to this evolution. Definitions of Acquiring Person, Beneficial Ownership, Affiliates, Associates and Acting Jointly or in Concert are the terms that set out the who, how, and when of a triggering event. These definitions in early poison pills contained repetitive, circular and duplicative layering of similar terms which created confusion and made interpretation difficult. Directors were given broad discretion to interpret the terms of a rights plan to determine when it was triggered, in other words, whether a takeover bid could proceed. This in turn, created enough uncertainty for bidders or potential purchasers, to effectively discourage non-board negotiated transactions. It can be seen how the early poison pill became synonymous with board and management entrenchment.

“New generation” rights plans have therefore been drafted to remove repetitive and duplicative elements along with language that gives the board discretion to interpret the terms of the plan. Also absent from “new generation” plans are

references to similar definitions in regulation. These definitions found in various regulations often contain repetitive elements and references to other definitions in regulation that are unacceptable and not intended to serve the same purpose as those found in a "new generation" rights plan.

A number of other definitions are relevant to the key definitions mentioned above and are therefore equally scrutinized. Exemptions under the definition of Acquiring Person, for example, such as Exempt Acquisitions and Pro Rata Acquisitions, are sometimes inappropriately drafted to permit acquisitions that should trigger a rights plan. In order for an acquisition to be pro rata, the definition must ensure that a person may not acquire a greater percentage of the shares outstanding than the percentage owned immediately prior to the acquisition, by any means. It should also be noted that "new generation" rights plans are premised on the acquisition of common shares and ownership at law or in equity, therefore references to the voting of securities or the extension of beneficial ownership to encompass derivative securities that may result in deemed beneficial ownership of securities that a person has no right to acquire, goes beyond the acceptable purpose of a rights plan.

Equally important to the acceptability of a shareholder rights plan is the treatment of institutional investors who have a fiduciary duty to carry out corporate governance activities in the best interests of the beneficial owners of the investments that they oversee. These institutional investors should not trigger a rights plan through their investment and corporate governance activities for the accounts of others. The definition of Independent Shareholders should make absolutely clear these institutional investors acting in a fiduciary capacity for the accounts of others are independent for purposes of approving a takeover bid or other similar transaction, as well as approving future amendments to the rights plan.

Probably one of the most important and most contentious definitions in a shareholder rights plan is that of a Permitted Bid. ISS guidelines provide that an acceptable Permitted Bid definition must permit partial bids. Canadian takeover bid legislation is premised on the ability of shareholders to make the determination of the acceptability of any bid for their shares, partial or otherwise, provided that it complies with regulatory requirements. In the event that a partial bid is accepted by shareholders, regulation requires that their shares be taken up on a pro rata basis. Shareholders of a company may welcome the addition of a significant new shareholder for a number of reasons.

Also unacceptable to the purpose of a rights plan is the inclusion of a "Shareholder Endorsed Insider Bid" (SEIB) provision which would allow an "Insider" and parties acting jointly or in concert with an Insider an additional less rigorous avenue to proceed with a take-over bid without triggering the rights plan, in addition to making a Permitted Bid or proceeding with board approval. The SEIB provision allows Insiders the ability to take advantage of a less stringent bid provision that is not offered to other bidders who must make a Permitted Bid or negotiate with the board for support.

Finally, a "new generation" rights plan must contain an exemption for lockup agreements and the definition of a permitted lockup agreement must strike the proper balance so as not to discourage either (i) the potential for a bidder to lock up a significant shareholder and thus give some comfort of a certain degree of success, or (ii) the potential for competitive bids offering a greater consideration and which would also necessitate a locked up person be able to withdraw the locked up shares from the first bid in order to support the higher competing bid.

New generation rights plans are limited to achieving the two purposes identified here. They ensure that shareholders are treated equally in a control transaction by precluding creeping acquisitions or the acquisition of a control block through private agreements between a few large shareholders; and they provide a reasonable time period to allow a corporation's directors and management to develop an alternative to maximize shareholder value.



4. Capital/Restructuring

Mergers and Corporate Restructurings

Overall Approach

For mergers and acquisitions, review and evaluate the merits and drawbacks of the proposed transaction, balancing the various and sometimes countervailing factors including:

- **Valuation** – Is the value to be received by the target shareholders (or paid by the acquirer) reasonable? While the fairness opinion may provide an initial starting point for assessing valuation reasonableness, emphasis is placed on the offer premium, market reaction and strategic rationale.
- **Market Reaction** – How has the market responded to the proposed deal? A negative market reaction should cause closer scrutiny of a deal.
- **Strategic rationale** – Does the deal make sense strategically? From where is value derived? Cost and revenue synergies should not be overly aggressive or optimistic, but reasonably achievable. Management should also have a favourable track record of successful integration of historical acquisitions.
- **Negotiations and process** – Were the terms of the transaction negotiated at arms-length? Was the process fair and equitable? A fair process helps to ensure the best price for shareholders. Significant negotiation “wins” can also signify the deal makers’ competency. The comprehensiveness of the sales process (e.g., full auction, partial auction, no auction) can also affect shareholder value.
- **Conflicts of interest** – Are insiders benefiting from the transaction disproportionately and inappropriately as compared to non-insider shareholders? As the result of potential conflicts, the directors and officers of the company may be more likely to vote to approve a merger than if they did not hold these interests. Consider whether these interests may have influenced these directors and officers to support or recommend the merger. The CIC figure presented in the “ISS Transaction Summary” section of this report is an aggregate figure that can in certain cases be a misleading indicator of the true value transfer from shareholders to insiders. Where such figure appears to be excessive, analyze the underlying assumptions to determine whether a potential conflict exists.
- **Governance** – Will the combined company have a better or worse governance profile than the current governance profiles of the respective parties to the transaction? If the governance profile is to change for the worse, the burden is on the company to prove that other issues (such as valuation) outweigh any deterioration in governance.



Reincorporation Proposals

Vote CASE-BY-CASE on proposals to change a company's jurisdiction of incorporation taking into account:

- Financial and corporate governance concerns, including: the reasons for reincorporating, a comparison of the governance provisions, and a comparison of the jurisdictional laws.

Generally vote FOR reincorporation when:

- Positive financial factors outweigh negative governance implications; or
- Governance implications are positive.

Generally vote AGAINST reincorporation if business implications are secondary to negative governance implications.



By-Law Amendments

Generally FOR the amendment or replacement of by-laws if:

- The purpose of the amendment is to clarify ambiguity, reflect changes in corporate law, streamline years of amendments or other “housekeeping” amendments and
- The by-laws as amended will not result in any of the unacceptable governance provisions set out in the following paragraph.

Generally vote AGAINST by-law amendments proposed individually or in a new by-law if any of the following conditions applies:

- The quorum for a meeting of shareholders is set below two persons holding 25% of the eligible votes (this may be reduced in the case of a small company where it clearly has difficulty achieving quorum at a higher level, but we oppose any quorum below 10%);
- The quorum for a meeting of directors is less than 50% of the number of directors;
- The chair of the board has a casting vote in the event of a deadlock at a meeting of directors;
- The proposed Articles/By-laws raise other corporate governance concerns, such as granting blanket authority to the board with regard to future capital authorizations or alteration of capital structure without shareholder approval.



Capital Structure

Increases in Authorized Capital

Vote CASE-BY-CASE on proposals to increase the number of shares of common stock authorized for issuance. Generally vote FOR proposals to approve increased authorized capital if:

- A company's shares are in danger of being de-listed;
- A company's ability to continue to operate as a going concern is uncertain.

Generally vote AGAINST proposals to approve unlimited capital authorization.

RATIONALE: Canadian jurisdictions generally, and most recently the British Columbia Corporations Act (BCCA), permit companies to have an unlimited authorized capital. ISS prefers to see companies with a fixed maximum limit on authorized capital, with at least 30 % of the authorized stock issued and outstanding. Limited capital structures protect against excessive dilution and can be increased when needed with shareholder approval.



Private Placement Issuances

Vote on these resolutions on a CASE-BY-CASE basis taking into account:

- Whether other resolutions are combined with the issuance; and
- The financial consequences for the company if the issuance is not approved.

Generally vote FOR private placement proposals if:

- The issuance represents up to 30 percent of the company's outstanding shares; and
- The use of proceeds from the issuance is disclosed and indicates a specific purpose for the issuance of such shares.



Blank Cheque Preferred Stock

Generally vote AGAINST proposals to create unlimited blank cheque preferred shares or increase blank cheque preferred shares where:

- The shares carry unspecified rights, restrictions and terms,
- The company does not specify the purpose for the creation or increase of such shares.

Generally vote FOR proposals to establish these shares where the company has stated in writing that the shares will not be used for anti-takeover purposes or in cases where the voting, conversion, and other rights, restrictions and terms of such stock are specified in the articles and are reasonable.



Dual-class Stock

Generally vote AGAINST proposals to create a new class of common stock that will create a class of common shareholders with diminished or superior voting rights.

The following is an exceptional set of circumstances under which we would generally support a dual class capital structure. Such a structure must meet all of the following criteria:

- It is required due to foreign ownership restrictions and financing is required to be done out of country;
- It is not designed to preserve the voting power of an insider or significant shareholder;
- The subordinate class may elect some board nominees;
- There is a sunset provision; and
- There is a coattail provision that places a prohibition on any change in control transaction without approval of the subordinate class shareholders.



Escrow Agreements

Generally vote AGAINST an amendment to an existing escrow agreement where the company is proposing to delete all performance-based release requirements in favour of the minimum time-driven release requirements.

RATIONALE: On going public, certain insiders of smaller issuers must place a portion of their shares in escrow. The primary objective of holding shares in escrow is to ensure that the key principals of a company continue their interest and involvement in the company for a reasonable period after public listing.



5. Compensation

Equity Compensation Plans

Vote on a CASE-BY-CASE basis on share-based compensation plans.

Generally vote FOR proposals to approve or increase the shares reserved under a stock option plan where:

- Annual basic dilution (not including warrants, shares reserved for equity compensation) for all equity compensation plans is not more than 10%; AND
- Average annual option burn rate is no more than 5% per year.

Generally vote AGAINST an equity compensation plan proposal if:

- The plan expressly permits the repricing of options without shareholder approval and the company has repriced options within the past three years.



Plan Amendment Provisions

Generally vote AGAINST a proposal to adopt or amend plan amendment provisions where shareholder approval is not required for the following types of amendments under any share-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 options beyond the original expiry;
- Any amendment which would permit options granted under the Plan may be transferable or assignable other than for normal estate settlement purposes; and
- Amendments to the plan amendment provisions.

RATIONALE: Although the changes affected by the TSX related to Plan Amendment Provisions, do not apply to TSXV issuers, some venture issuers continue to submit Plan Amendment Provisions for shareholder approval. In the event that shareholders are asked to vote on such a proposal, ISS uses substantially the same basic guidelines as those developed for TSX issuers which can be found with a more complete explanation in the ISS Canadian Proxy Voting Guidelines for TSX-listed issuers. Because TSX Venture issuers are not required to adopt detailed plan amendment provisions, these guidelines will not result in a vote against an equity-based compensation plan if the plan meets our dilution and burn rate guidelines noted above.

Any proposal to increase the maximum number of shares reserved under a plan requires specific shareholder approval for the increase even if the plan includes a shareholder-approved general amendment procedure permitting increases to such maximum numbers.

From a corporate governance viewpoint, ISS finds the practice of re-pricing any outstanding options unacceptable and does not limit this view to only those held by insiders. ISS has for many years recommended against any re-pricing of outstanding options. Our reasons are based on the original purpose of stock options as at-risk, incentive compensation that is meant to align the interests of option-holders with those of shareholders. Options have come to be viewed as a sort of substitute currency however, that may be used to compensate service providers and consultants. It is questionable, in our view, to expect that outsiders who have no direct impact on the business operations of a company can, through their relationships with the company contribute in any meaningful way to an increase in shareholder value. We would therefore

view the use of stock options as inappropriate for this purpose and see no justification for re-pricing any outstanding options when shareholders must suffer the consequences of a downturn in share price.

ISS 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 when shareholders must suffer the consequences of declining share prices does not align the interests of option holders with those of shareholders and removes the intended incentive to increase share price which was originally approved by shareholders.



Repricing Options

Generally vote AGAINST management proposals to reprice outstanding options, unless:

- Repricing is part of a broader plan amendment that improves the plan and provided that the following conditions are met:
- A value-for-value exchange is proposed;
- The five top paid officers are excluded; and
- Options exercised do not go back into the plan OR the company commits to an annual burn rate cap.

ISS also views the extension of option terms as unacceptable. Options are not meant to be a no-risk proposition and may lose their incentive value if the term can be extended when the share price dips below the exercise price. Shareholders approve option grants on the basis that recipients have a finite period during which to increase shareholder value, typically five to ten years. As a company would not shorten the term of an option to reign in compensation during profitable bull market runs, it is not expected to extend the term during a market downturn when shareholders must suffer a decrease in shareholder value.



Other Compensation Plans

Canadian Venture issuers tend to rely heavily on stock option plans as an alternative to cash compensation, however in the event that a venture issuer has an Employee Stock Purchase Plan or Deferred Share Unit Plan, we have included the following guidelines which are substantially similar to those for TSX listed issuers.

Employee Stock Purchase Plans (ESPPs, ESOPs)

Canadian venture companies do not usually implement these kinds of plans however, in the event that shareholders are asked to approve a share purchase plan, votes should be determined on a CASE-BY-CASE basis.

Generally vote FOR broadly based (preferably all employees of the company with the exclusion of individuals with 5% or more beneficial ownership of the company) employee stock purchase plans where all of the following apply:

- Reasonable limit on employee contribution (may be expressed as a fixed dollar amount or as a percentage of base salary excluding bonus, commissions and special compensation);
- Employer contribution of up to 25% of employee contribution and no purchase price discount;
- Purchase price is at least 80% of fair market value with no employer contribution;
- Potential dilution together with all other equity-based plans is ten percent of outstanding common shares or less; and

- Plan Amendment Provision requires shareholder approval for amendments to:
 - The number of shares reserved for the plan;
 - The allowable purchase price discount;
 - The employer matching contribution amount.



Deferred Share Unit (DSU) Plans

Generally vote FOR a DSU plan if:

- Potential dilution together with all other equity-based compensation is ten percent of the outstanding common shares or less.

Other elements of director compensation to evaluate in conjunction with deferred share units include:

- The mix of remuneration between cash and equity;
- Other forms of equity-based compensation, i.e. stock options, restricted stock; and
- Vesting schedule or mandatory deferral period.

RATIONALE: These types of deferred compensation arrangements encourage a sense of ownership in the company and are usually designed to compensate outside directors by allowing them the opportunity to take all or a portion of their annual retainer in the form of deferred units, the payment of which is postponed to some future time, typically retirement or termination of directorship and may be in cash and/or stock.

A DSU plan only requires shareholder approval if it reserves treasury shares. However, a number of companies continue to request shareholder approval for DSU plans funded by shares purchased in the open market.

Open Market Share Purchase Funded Plans

Eligibility and administration are key factors in determining the acceptability of such plans. In the event that a plan can be funded by either open market share purchases or treasury shares, it will be evaluated on a potential dilution basis.

Treasury Share Funded Plans

Deferred share units awarded under any equity compensation plan that requires the authorization of treasury shares for issuance in payment of the deferred units would be evaluated on a dilution, eligibility and administration basis.



Shareholder Proposals on Compensation

Vote on a CASE-BY-CASE basis for shareholder proposals targeting executive and director pay, taking into account the target company's performance, absolute and relative pay levels as well as the wording of the proposal itself.

Generally vote FOR shareholder proposals requesting that the exercise of some, but not all stock options be tied to the achievement of performance hurdles.



6. Social and Environmental Issues

Generally vote CASE-BY-CASE taking the following into consideration:

- Whether the information requested relates to a meaningful percentage of the company's business as measured by sales, assets and earnings;
- The degree to which the company's stated position on the issue raised, or lack thereof, could affect its reputation or sales, or leave it vulnerable to boycott or selective purchasing, or investor, regulatory or legal sanctions;
- Whether the issues presented should be dealt with through government regulation or policy changes;
- Whether the company has already responded in an appropriate manner to the request embodied in the proposal;
- Whether the company's analysis and voting recommendation to shareholders are persuasive;
- Whether the proposal itself is well framed and the cost of preparing a report, if requested, is reasonable;
- General industry standards for dealing with the issue taking into consideration the impact of globalization and acceptable standards for transnational corporations;
- Whether implementation of the proposal would achieve the objectives sought in the proposal;
- Whether the subject of the proposal is best left to the discretion of the board; and
- Whether the requested information is available to shareholders from the company or other publicly available sources.

RATIONALE: These issues cover a wide range of topics, including consumer and product safety, environment and energy, general corporate issues, labor standards and human rights, HIV/AIDS and other health related issues, military business, and workplace diversity.

In evaluating any shareholder proposal, ISS seeks to determine if a shareholder resolution is reasonable in both its scope and approach to a specific issue. In most cases, ISS' social and environmental issue voting recommendations will not seek to establish or enforce a "best practice" approach but rather we will establish industry standards to determine if the company falls outside of the accepted norms (thus creating risk exposure), evaluate the importance of the issue to the company's core business, and evaluate the potential for impact on share value.

In evaluating these types of proposals, ISS examines whether the issue should be addressed on a company-specific basis. Many social and environmental proposals are beyond the scope of any one company and either fall under the jurisdiction of provincial governments and/or require broader regulatory action. While a wide variety of factors goes into each analysis, the overall principal guiding all vote recommendations focuses on how the proposal may enhance the economic value of the company or conversely how it may reduce risk exposure that has the potential to substantially negatively impact shareholder value in either the short-term or long-term. Proposals seeking reasonable disclosure on corporate responsibility issues will be supported unless current disclosure in the targeted area by the company is already satisfactory.



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