



An MSCI Brand

Canadian Corporate Governance Policy

2011 Updates

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Research Central

Institutional Shareholder Services Inc.

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ISS' Canadian Corporate Governance Policy 2011 Updates

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RESEARCH COVERAGE

Corporate Governance Issue: Country of Incorporation vs. Country of Listing— Application of Policy

Current Policy Application: ISS currently applies its benchmark policy based on an issuer's country of incorporation, as generally this approach has been compatible with the appropriate regulatory and operating environment.

Key Change: Apply U.S. policy to issuers that are incorporated outside the United States but file DEF 14As, 10-K annual reports, and 10-Q quarterly reports, and are thus considered domestic issuers by the U.S. Securities and Exchange Commission (SEC).

New Policy Application: In general, country of incorporation will still be the basis for policy application. However, ISS will generally apply its U.S. policies to the extent possible with respect to issuers that file DEF 14As, 10-K annual reports, and 10-Q quarterly reports, and are thus considered domestic issuers by the U.S. Securities and Exchange Commission (SEC).

Rationale for Update: In recent years, certain companies that are listed on a U.S. exchange have "redomesticated," i.e., re-incorporated outside the United States. As a result, many of these issuers have found themselves subject to a combination of governance regulations and best practice standards that may not be entirely compatible with ISS' policy approach based exclusively on country of incorporation. The intent of this policy change is to apply policies that are more compatible with standards applicable in an issuer's market of operation. While incorporated outside the United States, issuers that are listed on a U.S. exchange are considered U.S. domestic issuers by the SEC. In our [2010-2011 Policy Survey](#), 85 percent of institutional investors surveyed were in favor of this change. The adoption of this policy will result in the transfer of approximately 74 companies to be evaluated generally under ISS' U.S. policies. In the future, we will continue to look at potential transfers of companies that are incorporated in one jurisdiction but listed elsewhere.



BOARD – TSX GUIDELINE

Corporate Governance Issue: Board Independence/Board Committee Structure

Majority Independent Board/Separate Compensation and Nominating Committees

Current Recommendation: FOR S&P/TSX Composite Companies Only:

Generally vote WITHHOLD from any insider or affiliated outside director (and the whole slate if the slate includes such individual directors) where:

- The board is less than majority independent; OR
- The board lacks a separate compensation or nominating committee.

Key Change: Expand application of policy to all TSX companies

New Recommendation: Applicable to All TSX Companies:

Generally vote WITHHOLD from any insider or affiliated outside director (and the whole slate if the slate includes such individual directors) where:

- The board is less than majority independent; OR
- The board lacks a separate compensation or nominating committee.

Rationale for Update: The policy update reflects best practice as it relates to board/committee independence.

The balance of board influence should reside with independent directors free of any pressures or conflicts which might prevent them from objectively overseeing strategic direction, evaluating management effectiveness, setting appropriate executive compensation, maintaining internal control processes, and ultimately driving long-term shareholder value creation. Canadian best practice as set out in National Policy 58-201 Corporate Governance Guidelines recommends that all company boards should have a majority of independent directors (Board Independence 3.1). In addition, National Policy 58-201 recommends that all company boards should appoint a nominating committee and a compensation committee composed entirely of independent directors (Nomination of Directors 3.10; Compensation 3.15).

A 2008 review of roughly 532 core¹ TSX reporting issuers revealed that 19 percent of these issuers either did not have majority independent boards or lacked either a compensation or nominating committee. A comparable review based on 2010 proxy season shows that of roughly 575 core TSX reporting issuers, about 29 percent fell short on at least one of these three standards.

The published voting guidelines of public funds and other large institutional investors now indicate that votes should be withheld from directors at any company where the board is less than majority independent. Furthermore, feedback from

¹ Core refers to those companies having more than 15 ISS institutional client shareholders.

ISS' policy outreach discussions indicates that an overwhelming majority of ISS' clients support application of this policy to the broader TSX market.



COMPENSATION – TSX GUIDELINE

Corporate Governance Issue: Equity Compensation Plans

Dilution and Burn Rate Assessment Where No Compensation Model Applies

Current Recommendation:

No formal written policy specifically addressing this need.

Key Change: Codify current practice into policy to supplement the Cost of Equity Plan policy where the compensation model cannot be run applied to lack of historic data for plans introduced as part of Income Trust Conversion or other M&A transaction.

New Recommendation:

Vote CASE-BY-CASE on equity-based compensation plans. Vote AGAINST the plan if any of the following factors applies:

- Cost of Equity Plans: The total cost of the company's equity plans is unreasonable
 - Dilution and Burn Rate: Dilution and burn rate are unreasonable, where the cost of the plan cannot be calculated due to lack of relevant historical data
- Plan Amendment Provisions: The provisions do not meet ISS guidelines
- Non-Employee Director Participation: Participation of directors is discretionary or unreasonable
- Pay for performance: There is a disconnect between CEO pay and the company's performance
- Repricing Stock Options: The plan expressly permits the repricing of stock options without shareholder approval
- Problematic Pay Practices: The plan is a vehicle for problematic pay practices.

Cost of Equity Plans

Our methodology for reviewing share-based compensation plans primarily focuses on the transfer of shareholder wealth (the dollar cost of share plans to shareholders) instead of simply focusing on dilution. Using information disclosed by the company and assuming the broadest definition of plan terms, ISS will value equity-based awards using a binomial option pricing model. ISS will include in its analyses an estimated dollar cost for the proposed plan and all continuing plans. This total cost will be expressed as a percentage of market value (i.e. 200-day average share price time common shares outstanding). This result is tested for reasonableness by comparing the figure to an allowable cap derived from compensation plan costs of the top performing quartile of peer companies in each industry group (using Global Industry Classification Standard GICS codes). Benchmark SVT levels for each industry are established based on these top performers' historic SVT. Regression analyses are run on 44 different variables including company size, market-based performance metrics, and accounting-based performance metrics, for each industry group to identify the variables most strongly correlated to SVT. The benchmark industry SVT level is then adjusted upward or downward for the specific company by incorporating the company-specific performance measures, size and cash compensation into the industry cap equations to arrive at the company's allowable cap.

Dilution and Burn Rate Assessment

In cases where the cost of the plan cannot be calculated using the binomial model due to lack of historic data for a newly created or merged corporate entity, ISS will apply a dilution and burn rate analysis.

Generally vote AGAINST the proposed equity plan if the dilution under all company plans would be more than 10 percent of the outstanding shares on a non-diluted basis, OR if the historic burn rate for all company plans has been more than 2 percent per year. If equity has been granted as part of the resolution subject to shareholder approval and the grants made exceed 2 percent of the outstanding shares a vote AGAINST is warranted.

Rationale for Update: In a limited number of cases, it is not possible to calculate the SVT using the binomial model due to a lack of historical data required for certain model inputs. This situation arises in the case of income trust conversions and other M&A transactions where the resulting corporate entity would not have enough relevant historic data (i.e., average share price or volatility), to use a binomial model evaluation. The dilution and burn rate assessment described here has been implemented in these cases and the policy document is being updated to reflect this additional policy application. The thresholds implemented in the policy reflect the maximum allowable as per the guidelines of institutional investors.



CAPITAL/RESTRUCTURING – TSX GUIDELINE

Corporate Governance Issue: Articles of Incorporation/ By-Laws

Current Recommendation:

Generally vote FOR proposals to amend or replace bylaws 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 bylaws as amended will not result in any of the three unacceptable governance provisions set out in the following paragraph.

Vote AGAINST a new bylaw proposal, if any of the following conditions applies:

- The quorum for a meeting of shareholders is set below two persons holding 25 percent of the eligible vote (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 percent);
- The quorum for a meeting of directors is less than 50 percent of the number of directors; and
- The chair of the board has a casting vote in the event of a deadlock at a meeting of directors.

Key Change: Clarify that an against recommendation may also result if the proposed articles/bylaws raise other corporate governance concerns such as granting blanket discretionary authority to the board related to capital authorization or alteration of capital structure without shareholder approval.

New Recommendation:

Generally vote FOR proposals to amend or replace articles of incorporation or bylaws 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 bylaws as amended will not result in any of the unacceptable governance provisions set out in the following paragraph.

Vote AGAINST proposals to amend or replace articles/bylaws if any of the following conditions applies:

- The quorum for a meeting of shareholders is set below two persons holding 25 percent of the eligible vote (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 percent);
- The quorum for a meeting of directors is less than 50 percent 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; and
- The proposed articles/bylaws raise other corporate governance concerns, such as granting blanket authority to the board with regard to capital authorizations or alteration of capital structure without shareholder approval.

Rationale for Update: ISS includes three specific criteria in its policy guidelines with respect to article or bylaw provisions that raise investor concerns regarding shareholder rights and independent board representation. In addition, board discretion to adopt or implement practices that would have a negative impact on shareholders without giving shareholders

the opportunity to vote on such actions should not be supported. For example, blanket authority granting the board discretion to create or issue an unlimited number of blank check preferred shares without prior shareholder approval would not be supported.



SHAREHOLDER RIGHTS & DEFENSES – TSX GUIDELINE

Corporate Governance Issue: Poison Pills (Shareholder Rights Plans)

Current Recommendation:

Vote CASE-BY-CASE on management proposals to ratify a shareholder rights plan (poison pill) taking into account whether it conforms with "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;
 - Flip-over provision;
 - Permitted bid period greater than 60 days;
 - Maximum triggering threshold set at less than 20 percent of outstanding shares;
 - Does not permit partial bids;
 - 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.

Key Change: Add reference to two new unacceptable features: Shareholder Endorsed Insider Bid and Derivatives Clause found in the key definitions, each of which would result in an against vote recommendation.

New Recommendation:

Vote CASE-BY-CASE on management proposals to ratify a shareholder rights plan (poison pill) taking into account whether it conforms with "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 definition of Beneficial Owner;
 - Flip-over provision;
 - Permitted bid period greater than 60 days;
 - Maximum triggering threshold set at less than 20 percent of outstanding shares;
 - Does not permit partial bids;
 - Includes Shareholder Endorsed Insider Bid 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 for Update: 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. Under the provision, the person's deemed ownership extends, as well, to any securities owned by an associate or affiliate of the counterparty and includes any securities owned by any second counterparty (and its associates or affiliates) with whom the first counterparty or any of its associates or affiliates enters into a derivatives contract and any successive counterparties with whom any of the previously described persons or any of their associates or affiliates enters into a derivatives contract. As a result, the receiving party may be deemed to own beneficially securities (defined in the Plan as "notional securities") that it has no right to acquire. And if a derivatives contract gives the receiving party a right to acquire the securities to which it relates, the securities would be treated as beneficially owned under the provision (standard paragraph (b) or (ii)) that catches any securities as to which a person or its affiliates or associates has the right to become the owner at law or in equity, where such right is exercisable immediately or within 60 days of the date of the determination of beneficial ownership.

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 avenue to proceed with a takeover bid without triggering the rights plan, in addition to making a Permitted Bid or proceeding with board approval. The SEIB provision generally permits an Insider holding 10 percent of the voting shares to launch a bid by means of a takeover bid circular and requires that more than 50 percent of the common shares held by shareholders other than the

Insider and its joint actors, have been tendered to the takeover bid at the time of first take up under the bid. 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.



BOARD – TSX VENTURE GUIDELINE

Corporate Governance Issue: Insiders on Key Committees

Current Recommendation:

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 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 compensation committee and the board is not majority independent.

The existence of nominating committees among venture issuers is still rare and for this reason we have not extended this policy to nominating committees at this time.

Key Change: Extending the policy to include the nominating committee.

New Recommendation:

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 or nominating committee and the committee is not majority independent.

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

- Are insiders and the entire board fulfills the role of a compensation or nominating committee and the board is not majority independent.

Rationale for Update: While roughly three-quarters of reporting venture issuers still do not have a separate nominating committee, in cases where there is a separate nominating committee in place, the expectation should be that this key committee should also be majority independent just as the entire board is expected to be majority independent if fulfilling this role. This policy change reflects the growing recognition of the importance of an independent nominating committee and an increased demand for substantive corporate governance requirements even at the venture level, as expressed by institutional investors recently in response to proposed regulatory change that would ease requirements for venture issuers.

