

BACKGROUND

In *2010 Building High Performance Boards*, the Canadian Coalition for Good Governance (“CCGG”) developed a set of guidelines to help ensure that the board of a public company:

- is accountable and independent
- has experienced, knowledgeable and effective directors committed to the highest level of integrity
- has clear roles and responsibilities, and
- engages with its shareholders.

(See www.ccg.ca for the complete version of *2010 Building High Performance Boards*. All references to “CCGG Guidelines” in this document are to the guidelines in *2010 Building High Performance Boards*).

Many large Canadian corporations are controlled by a family, a parent company or a group of shareholders through their holdings of common shares. Effective equity control can come from holding as little as 20% of the common shares of a widely held company. CCGG recognizes that the guidelines in *2010 Building High Performance Boards* may not apply equally to equity controlled companies. The purpose of this document is to supplement those guidelines to take into account the legitimate governance differences of equity controlled corporations.

These guidelines relate only to those corporations which are controlled through the ownership of common shares, and not to corporations which are controlled by virtue of multiple-voting or dual class share structures. CCGG will prepare guidelines for dual class share companies, which have unique governance issues, in the future.

In general, CCGG recognizes that a controlling shareholder may have a legitimate interest in being actively involved in the board of directors of the corporation. In fact, many institutional investors expect shareholders that control a corporation by virtue of their equity holdings to have substantial influence over the strategic direction of the company, the election of some of the directors, the appointment of executives, the financial affairs of the business and executive compensation. CCGG believes that while the representation of the controlling shareholder on the board and its influence over the corporation is often valuable, representation generally should be proportional to the controlling shareholder’s equity holdings. A board always should have a meaningful number of independent directors who are not related to the controlling shareholder or management.

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All public companies should strive to have their governance practices go beyond legal minima to ensure excellence. CCGG expects that all public companies will follow the governance guidelines set out in *2010 Building High Performance Boards*, subject to the following principles applicable to controlled corporations.

DEFINITIONS

In this document:

- **“CEO”** means the Chief Executive Officer of the corporation or a person holding the most senior executive office in the corporation who performs the functions of a chief executive officer.
- **“Controlled Corporation”** means a corporation controlled by a Controlling Shareholder or group of shareholders who together (directly or indirectly) control a sufficient number of common shares of the corporation to be able to elect the board of directors or to direct the management or policies of the corporation.
- **“Controlling Shareholder”** means a person or company that directly or indirectly controls a sufficient number of common shares of a corporation to be able to elect the board of directors or to direct the management or policies of the corporation.
- **“Independent Director”** means a director who has no direct or indirect material relationship with the corporation, meaning a relationship which could, in the view of the corporation’s board of directors, be reasonably expected to interfere with the exercise of a director’s independent judgment¹.
- **“Related”**, when referring to the relationship between the CEO or other management and the Controlling Shareholder, means an executive of the Controlled Corporation who also is (i) directly or indirectly a Significant Shareholder of the Controlling Shareholder, (ii) directly or indirectly employed by the Controlling Shareholder (or one of its Significant Shareholders) or (iii) an immediate family member of the Controlling Shareholder (or one of its Controlling Shareholders). A CEO or other executive will not be considered to be related to the Controlling Shareholder solely because he or she is a member of the board of directors of the Controlling Shareholder.
- **“Related Director”** means a director who is (i) directly or indirectly a Significant Shareholder of the Controlling Shareholder, (ii) directly or indirectly employed by the

¹ For these purposes, CCGG adopts the definition of a “independent” contained in Section 1.4 of National Instrument 52-110 *Audit Committees* of the Canadian Securities Administrators. Under this definition, “corporation” includes a parent of the corporation and accordingly a director who has a direct or indirect material relationship with the Controlling Shareholder is not independent of the corporation even if he or she is independent of management of the corporation.

Controlling Shareholder (or one of its Significant Shareholders) or (iii) an immediate family member² of the Controlling Shareholder (or one of its Significant Shareholders). A member of the board of directors of a Controlling Shareholder who is otherwise independent of the family or entity that controls the Controlling Shareholder will not be considered a Related Director of the Controlled Corporation solely because he or she is a member of the board of directors of the Controlling Shareholder. A Related Director may or may not be independent of management of the Controlled Corporation.

- **“Significant Shareholder”** means a person or company that controls, directly or indirectly, at least 20% of the common shares of a corporation.

Regulatory Definition of an “Independent Director”

CCGG has urged members of the Canadian Securities Administrators (“CSA”) to change the current regulatory definition of an “independent director” in National Instrument 52-110 *Audit Committees*. CCGG believes that a distinction should be made between a director who is independent of management and a director who is independent of management but has a material relationship with a Controlling Shareholder. The current regulatory definition may deem a director who has a material relationship with a Controlling Shareholder not to be “independent”, even if he or she is independent of management.

In 2008, the CSA proposed to revise the definition of an “independent director” to mean only independence from management of the company.³ CCGG encourages the CSA to move forward with that amendment which would allow a Related Director who is independent from management but has a material relationship with a Controlling Shareholder to have greater participation on the Controlled Corporation’s board and its committees including, for example, the ability to sit on an Audit Committee.

² As “immediate family member” is defined in Section 1.1 of National Instrument 52-110 *Audit Committees* of the Canadian Securities Administrators.

³ See the December 19, 2008 Request for Comment – Proposed Repeal and Replacement of NP 58-201 *Corporate Governance Guidelines*, NI 58-101 *Disclosure of Corporate Governance Practices*, and NI 52-110 *Audit Committees* and Companion Policy 52-110CP *Audit Committees*. CCGG’s response to this Request for Comments is available at http://www.ccg.ca/site/ccgg/assets/pdf/CCGG_CSA_Corporate_Governance_Submission_-_April_20_2009.pdf.

REVISED GUIDELINES

The following supplements certain of CCGG's existing guidelines in 2010 Building High Performance Boards with new guidelines that are applicable to Controlled Corporations.

Guideline #1 - Shareholder Democracy

(Relating to Guideline One in 2010 Building High Performance Boards)

Controlled Corporations should allow shareholders to vote “for” or “against” each individual director nominee and promptly disclose the detailed vote results following each election. The board of a Controlled Corporation should commit publicly to adopt immediately CCGG’s Majority Voting Policy if the Controlling Shareholder ceases to control 50% or more of the common shares.

The nominating committee of a Controlled Corporation should have a process to receive and discuss suggestions from shareholders for potential director nominees.

CCGG recommends that boards of all public companies facilitate shareholders’ ability to effectively vote their shares “for” or “against” individual directors by adopting the CCGG Majority Voting Policy.⁴ CCGG continues to urge the CSA and other regulators to make the necessary amendments to eliminate the plurality system of director elections in order to allow shareholders to vote “for” or “against” individual directors and to provide that in an uncontested director election, only directors who receive a majority of votes in their favour will be elected to a board.

The CCGG Majority Voting Policy commits a board to (1) hold director- by-director elections, (2) promptly disclose the detailed results of each election, and (3) require a director who receives more votes “withheld” than “for” to tender his or her resignation to the board. The board must promptly consider the resignation and, other than in exceptional circumstances, accept it.

Generally, Controlled Corporations should allow shareholders to vote “for” or “against” each individual director nominee and should adopt the CCGG Majority Voting Policy. However, CCGG recognizes that if a Controlling Shareholder holds 50% or more of the common shares, it is highly unlikely that more votes for an individual director will be “withheld” than are voted “for” and therefore adopting the CCGG Majority Voting Policy would rarely lead to the resignation of a director. Accordingly, CCGG believes that the board of a Controlled Corporation should adopt a board policy that commits the Controlled Corporation to:

1. allow shareholders to vote for each individual director
2. disclose the results of director elections promptly after each annual meeting, and
3. immediately adopt the CCGG Majority Voting Policy if at any time the Controlling Shareholder controls less than 50% of the common shares.

⁴ See the 2011 CCGG Majority Voting Policy, available at www.ccg.ca.

The board of a Controlled Corporation also should ensure that it has processes in place to allow interested minority shareholders to nominate directors and that those nominations are formally considered by the board's nominating committee. For example, the annual proxy circular could disclose a process whereby shareholders could submit suggested individuals to the chair of the nominating committee for consideration before the next annual meeting.

Guideline #2 - Board Composition

(Relating to Guideline Two in 2010 Building High Performance Boards)

The number of Related Directors of a Controlled Corporation should not exceed the proportion of the common shares controlled by the Controlling Shareholder, to a maximum of two thirds. However, if the CEO is related to the Controlling Shareholder, then at least two thirds of the directors of a Controlled Corporation should be Independent Directors.

CCGG recommends that at least two thirds of the board of directors of every public company that is not a Controlled Corporation should be independent of management.

For Controlled Corporations, it can be valuable to the company for Related Directors (such as professional advisors to or owners or executives of the Controlling Shareholder) to sit on the board, but the number of Related Directors should be proportional to the common share ownership of the Controlling Shareholder, to a maximum of two thirds.

However, if the CEO of the Controlled Corporation is Related to the Controlling Shareholder, CCGG believes that the other Related Directors also are not independent of management. In those circumstances, in order to ensure the independent oversight of management, proper management of conflicts of interest and the protection of the interests of minority shareholders, two thirds of the board of the Controlled Corporation should be Independent Directors.

Guideline #3 - Independent Chair

(Relating to Guideline Three in 2010 Building High Performance Boards)

The Chair of the Board and CEO of every public company that is not a Controlled Corporation should be separate roles held by different people, as these roles have different responsibilities and functions.

If a Controlling Shareholder controls at least 50% of the common shares of a Controlled Corporation, the CEO and Chair roles may be combined, or the CEO may be the Controlling Shareholder or related to it, provided that there is a lead director who is an Independent Director and the board has an effective and transparent process to deal with any conflicts of interest between the Controlled Corporation, minority shareholders and the Controlling Shareholder.

In every public company that is not a Controlled Corporation, the roles of board Chair and CEO are fundamentally different and should be held by different individuals. The Chair should always

be independent of management and should not participate in management or have a material relationship with management or the corporation that would lead a reasonable person to believe that he or she is not truly independent.⁵ In a widely held public company, an independent Chair plays an integral role in providing the necessary impartial oversight of management.

If a Controlling Shareholder controls at least 50% of the common shares of a Controlled Corporation, the influence of the Controlling Shareholder may make the appointment of an independent Chair impracticable. In such Controlled Corporations, the roles of CEO and Chair may be combined or the Chair may be a Related Director who is also actively involved in management of the business (sometimes called an “Executive Chair”). Alternatively, the Chair may be a Related Director and the CEO may be Related to the Controlling Shareholder. If the Controlling Shareholder controls a majority of the common shares these governance structures are acceptable, provided that there is a lead director who is an Independent Director.

The lead director should be appointed by the Independent Directors. The lead director’s role should be to set board agendas with the Chair and CEO, be responsible for the quality of information sent to the directors, chair in camera meetings when needed and be the liaison between the Controlling Shareholder and the Independent Directors. The lead director should also be a conduit for shareholders to raise issues of concern and should be available to engage with shareholders appropriately. The lead director should be the person responsible for ensuring that there are appropriate procedures in place to identify and manage conflicts of interest between the Controlled Corporation, minority shareholders and the Controlling Shareholder.

If the CEO and Chair roles have been combined or if the CEO is related to the Controlling Shareholder, the board should disclose to shareholders why it has adopted that structure and why it believes that it is in the best interests of the corporation and all of its shareholders. The board should continually monitor the effectiveness of that structure and the role of the lead director and consider modifying it if necessary.

Guideline #4 - Related Directors on Board Committees

(Relating to Guideline Six of 2010 Building High Performance Boards)

At least one member of each board committee of a Controlled Corporation should be an Independent Director. In addition, a majority of the members of all board committees (with the exception of the compensation committee) should be either Independent Directors or Related Directors who are independent of management of the Controlled Corporation.

⁵ For example, see Section 1.5 of National Instrument 52-110 **Audit Committees** of the Canadian Securities Administrators which considers a person to have a material relationship with the company if he or she accepts, directly or indirectly, any consulting, advisory (including investment banking, legal or accounting) or other compensatory fees from the company, other than directors’ fees, or if his or her spouse or child living in his or her home accepts such fees.

All members of the compensation committee should be independent of management of the Controlled Corporation. In addition, if the CEO is related to the Controlling Shareholder, no more than one member of the compensation committee should be a Related Director.

National Instrument 52-110 *Audit Committees* generally provides that no member of the audit committee may be a Related Director. CCGG is of the view that given their connection to the Controlling Shareholder, Related Directors can bring an important perspective to the audit committee which may add value to the Controlled Corporation.

Similarly, boards of public companies that are not Controlled Corporations usually have compensation and nominating committees comprised entirely of Independent Directors. CCGG believes that it is appropriate for Related Directors who are independent of management to sit on the compensation or nominating committees of a Controlled Corporation to bring the knowledge and perspective of the Controlling Shareholder to executive compensation, appointments and board nominations. However, if the CEO is related to the Controlling Shareholder, the compensation committee should include no more than one Related Director, and he or she should not participate in discussions about the CEO. This procedure will ensure that the compensation of the CEO is determined by Independent Directors.

The participation of Related Directors on board committees could give rise to conflicts of interest between the Controlled Corporation and the Controlling Shareholder which may require Related Directors to recuse themselves. As a result, boards should consider carefully each committee's quorum requirements to ensure that a single director is never asked to approve a conflict of interest transaction. If conflicts arise frequently (as they may in large, complex corporate groups or where members of senior management are Related to the Controlling Shareholder), the board should consider creating a conflict of interest committee made up entirely of Independent Directors to address conflicts on behalf of the board.

Guideline #5 – Assess the CEO and Plan for Succession

(Relating to Guideline Ten of 2010 Building High Performance Boards)

If the CEO is Related to the Controlling Shareholder, the board's process to evaluate the performance, leadership, compensation and succession of management should be led by Independent Directors.

Where the CEO is Related to the Controlling Shareholder, the board of a Controlled Corporation should put in place an objective and independent process to consider executive appointments, performance evaluations, compensation and succession planning that is led by Independent Directors. This procedure will ensure that those decisions are not unduly influenced by the Controlling Shareholder and reflect the views of the entire board.

Guideline #6 - Shareholder Engagement

(Relating to Guideline Thirteen of 2010 Building High Performance Boards)

CCGG believes that the board of a Controlled Corporation should encourage Independent Directors and Related Directors to engage with the company's shareholders to discuss relevant governance issues.

CCGG's Board Engagement Policy⁶ was prepared to encourage public companies to allow shareholders to meet with directors who are independent of management to ensure that the board is aware of the views of shareholders on governance matters. In the case of a Controlled Corporation, minority shareholders should be able to engage both with the Independent Directors as well as the Related Directors, either together or separately as may be appropriate for the issues to be discussed.

Guideline #7 - Say on Pay

(Relating to Guideline Thirteen of 2010 Building High Performance Boards)

CCGG believes that every public company, including Controlled Corporations, should hold an annual shareholder advisory vote on compensation and publicly disclose the detailed vote results.

A board's approach to executive compensation is an important indication of the board's governance of the company. As a result, CCGG believes that every public company, including Controlled Corporations, should hold an annual 'say on pay' advisory vote and publicly disclose the detailed vote results. Although for some Controlled Corporations the result of that vote may be dictated by the Controlling Shareholder, CCGG believes that it is an important vehicle through which minority shareholders can express their view on the board's approach to executive compensation.

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⁶ Available at www.ccg.ca

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