Canadian Coalition for
GOOD GOVERNANCE

THE VOICE OF THE SHAREHOLDER

May 4, 2009

Attention:

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VIA EMAIL

Re: Request for Comment – Proposed Changes to Part VI of the Toronto Stock Exchange Company Manual (April 3, 2009)

We are pleased to provide you with the comments of the Canadian Coalition for Good Governance ("CCGG") on the proposed changes to the Toronto Stock Exchange ("TSX") Company Manual (the "Manual") referenced above.

Representing the interests of institutional shareholders, CCGG promotes good governance practices in Canadian public companies and the improvement of the regulatory environment to best align the interests of boards and management with those of their shareholders, and to promote the efficiency and effectiveness of the Canadian capital markets. CCGG has over 40 members who collectively manage in excess of $1.1 trillion of savings on behalf of most Canadians.

GENERAL COMMENTS

The following are our general comments which will be followed by our response to each of the specific questions posed by the TSX.

GENERAL COMMENT#1: Shareholder approval of dilutive transactions is an essential component of good corporate governance

We are pleased that the TSX has recognized that shareholder approval should be required for significantly dilutive acquisitions, irrespective of whether the target is a private or public company. CCGG members believe that requiring shareholder approval for significant acquisitions is important and forms part of a system of checks and balances needed to protect investors and maintain investor confidence.

This view is widely accepted, including by the OSC, OECD and NYSE:

- The Ontario Securities Commission ("OSC") has recently recognized that the failure to protect shareholders has broad implications for the quality of Canada's capital market. When considering the rights of shareholders in a company proposing a dilutive transaction, the OSC recently found that, "[f]air treatment of shareholders is a key consideration going to the integrity and quality of the capital markets".[1]

- The Organization for Economic Cooperation and Development ("OECD") has noted that the approval of extraordinary transactions is one of the most basic rights of shareholders. In its *Principles of Corporate Governance*, the OECD recognizes that shareholders should have the right to participate in fundamental corporate changes, including the authorization of additional shares.[2]

- In1955, when the NYSE implemented its rule requiring shareholder approval for share issuances resulting in dilution in excess of 20%, it viewed it as "closing a loophole" in the law which required shareholder approval for mergers, consolidations or recapitalizations but not for acquisitions. In 1989, it stated that the approval of certain significant transactions by shareholders is an important aspect of its corporate governance listing standards.

[1] *In the matter of HudBay Minerals Inc. and A Decision of the Toronto Stock Exchange* (23 January 2009) (OSC Decision) and (28 April 2009) (OSC Reasons and Decision)
[2] OECD Principles of Corporate Governance, 2004, available at: www.oecd.org/daf/corporateaffairs/principles/text. See Part I, s. II. B. and Part II, s. II.

GENERAL COMMENT#2: The proposed dilution limit is too high

CCGG members do not agree that 50% dilution is the appropriate limit above which shareholder approval should be required as it is both far in excess of global standards, as well as the approval threshold for the acquisition of private companies.

The NYSE, Amex, NASDAQ, London Johannesburg and Hong Kong[3] exchanges all require shareholder approval for transactions that result in dilution ranging from 20% to 30%. In addition, most European corporate law requires shareholder approval for share issuances resulting in significant dilution. (In France, for example, shareholder approval is required for transactions resulting in dilution of more than 10% if shares are not issued first to existing shareholders.)

We are of the view that 20% is the appropriate threshold for the acquisition of public companies, which mirrors the requirements of all the major U.S. exchanges, and that the private company threshold should be reduced to this 20% level from its current 25%.

GENERAL COMMENT#3: There should be no distinction between the acquisition of public and private companies

CCGG members also disagree with the TSX's decision to continue to distinguish between acquisitions of public and private companies and to allow greater dilution without shareholder approval when a public company is acquired.

The TSX asserts that the distinction is appropriate because public information is available on the target and market participants are therefore "better able to assess the merits of a transaction". In our view, the ability of shareholders to assess the merits of a transaction is meaningless if they are not given the right to approve it.

The TSX also asserts that public scrutiny of the information available about a public company target, including its market value, will impose an effective discipline on "management" of an aquiror. In our view, the best discipline on management is to allow shareholders to assess a proposed transaction and vote to approve or reject it.

In its Request for Comments, the TSX states that it "believes that security holders should be provided with an opportunity to vote on acquisitions which may significantly alter their

[3] Contrary to the statements in the TSX Request for Comments, the Hong Kong Exchange requires all share issuances (with certain exceptions such as stock options) to be approved by shareholders. At an AGM, shareholders can prospectively approve the company issuing up to 20% of shares although that approval must be renewed annually. Anything above the 20% dilution level requires shareholder approval. The 50% test referred to by the TSX applies in circumstances where a transaction – whether paid in cash or shares – exceeds 50% dilution measured four different ways. That 50% rule is in addition to the need for shareholder approval for share issuances in excess of 20%.

investment through dilution”. That principle should apply equally whether a private or public company is being acquired.

The maximum dilution limit without shareholder approval for either type of transaction should be 20% or, at most, the current level of 25% for private company acquisitions. This level would rationalize the requirements for the acquisition of public and private companies and discounted private placements. However, members of the CCGG would prefer to see the dilution limit set at 20% to align the TSX rules with those of the U.S. markets.

GENERAL COMMENT#4: The nature of the Canadian marketplace does not justify departing from international norms

We recognize that the TSX has a significant number of small resource issuers. Those issuers rely on acquisitions in order to grow and typically use securities as consideration rather than cash. However, CCGG members do not believe that this feature of the Canadian capital market is significant enough to justify departing from internationally accepted best practices or should change the governance regime for all TSX listed companies. By analogy, small technology companies listed on NASDAQ similarly rely on acquisitions for growth and the issuance of securities to finance those acquisitions but must obtain shareholder approval for any acquisition resulting in dilution greater than 20%.

RESPONSES TO SPECIFIC QUESTIONS

1. Is it appropriate to maintain the exemption from security holder approval for the acquisition of public companies, provided the acquisition does not significantly alter the nature of the security holder’s investment through dilution?

Yes. Our members are of the view that shareholder approval should only be required if shares issued in consideration for an acquisition result in dilution to existing shareholders in excess of 20%.

2. Will the Amendment dampen M&A activity? Will it make transactions more difficult to complete? How much of an impact will the Amendment have on deal certainty?

The CCGG does not believe that strategic acquisitions will be discouraged by the Amendment nor will they be more difficult to complete. While it may affect the tactics used, obtaining shareholder approval will not necessarily require that a takeover bid remain open beyond the minimum 35 day deposit period.[4]

[4] Under NI 54-101, the minimum time to initiate the shareholder meeting process and hold a shareholder meeting is 55 days. However, the Instrument provides that those time requirements may be abridged (ss. 2.5(1) and 2.20) as long as all materials are mailed to shareholders at least 21 days prior to the meeting.

Our members believe that good business judgment by directors should lead to the inclusion of shareholders in the decision-making process when considering important, enterprise changing acquisitions. In fact, there have been cases where acquiring boards have voluntarily taken acquisition proposals to shareholders for their approval, in spite of there being no legal or exchange requirement to do so.[5]

With respect to deal certainty, the CCGG believes that once a dilution limit is established, parties will be able to plan their transactions accordingly. In *HudBay*, the OSC noted that participants in the NYSE market have managed to deal with any uncertainty that its 20% dilution limit creates. Furthermore, the OSC found that "fair treatment of shareholders is fundamentally more important than any consideration as to "deal certainty"…"

3. Do you think the Amendment will affect the competitiveness of the issuers listed on TSX? If so, how?

CCGG members do not think that the Amendment will affect TSX issuers' competitiveness since all major exchanges around the world, either directly or through corporate law, already require shareholder approval of dilutive transactions, with no exception for the acquisition of public companies. To the contrary, we have been concerned that the absence of a requirement for shareholder approval of significant dilutive transactions has the potential to diminish investor confidence in TSX listed issuers and make investment in them less likely, thereby raising the cost of capital for TSX listed issuers and making them less competitive.

We note that in *HudBay,* the OSC recognized that its decision to require a shareholder vote would foster confidence in our capital markets.

4. Do you think the Amendment strikes the appropriate balance between the interests of security holders, issuers and other market participants? Why or why not?

CCGG members do not think that the Amendment strikes the appropriate balance between shareholders and issuers because the proposed dilution limit of 50% is too high. Dilution at that level could result in a legal change of control as opposed to a change in effective control that is possible at the 20% limit. A threshold of 20% corresponds to the definition of a take-over bid under the Ontario *Securities Act* and would strike the appropriate balance between the legitimate interests of a board of directors and the ownership rights of shareholders.

[5] For example, in February, 2005, Goldcorp sought shareholder approval for the issuance of 200,000,000 Goldcorp shares to enable the purchase of Wheaton River Minerals. As noted on page 3 and 14 of the circular, "Although Goldcorp does not believe that applicable corporate law and securities law requirements require the issuance of the Consideration Shares to be approved by the Goldcorp Shareholders, Goldcorp has included a condition in the Offer to Purchase that the Share Issuance Resolution be approved by the Goldcorp Shareholders at the Goldcorp Meeting". In addition, Alcan's board intended to voluntarily seek shareholder approval for its three way merger with Pechiney and Allusuisse. The transaction was structured as an all-stock transaction with Alcan as the surviving entity and dilution to the shareholders well in excess of 25%. Ultimately, the deal failed to win approval of European anti-trust regulators.

5. What are the principal costs and benefits of the approach proposed in the Amendment? Please explain your response with reference to the various stakeholders.

The principal benefit of the Amendment (provided that the maximum dilution level is changed) will be to bring the TSX listing requirements in line with that of other exchanges and internationally accepted best practices. By doing so, the TSX will foster investor confidence in TSX listed issuers, encouraging investment in them and lowering the cost of capital for all TSX listed companies.

The need for shareholder approval could lead to some increased costs, such as the cost of holding a meeting, higher bid prices or larger break-fees (although presumably shareholders would not allow an over-priced bid to proceed once they are able to vote), but in the view of our members, any additional costs will be immaterial in the context of the other expenses of the transaction and are outweighed by the need to ensure fairness to shareholders and the integrity of the Canadian capital markets.

6. Do you expect that the Amendment will lead to transactions being structured to avoid security holder approval? If so, do you believe that this would be inappropriate and if so, why?

The CCGG believes that the board of directors of a public company should seek the approval of its shareholders before proceeding with an acquisition of significant size, whether the consideration for the acquisition is shares or some other form of compensation. However, share issuances that result in dilution to existing shareholders are of more concern because they can fundamentally affect shareholders' economic interests. In *HudBay*, the OSC considered dilution to be an "extremely important consideration" because it affects shareholders' economic interests and their voting, distribution and residual rights. While issuers may choose to finance acquisitions through greater reliance on cash and debt in order avoid the need for shareholder approval, doing so would not affect the integrity of a shareholder's ownership interest in the same way as a dilutive share issuance. Dilution is a particular concern in Canada because Canadian issuers, unlike issuers incorporated in the United States, almost invariably have unlimited authorized common share capital. Without the Amendment, the potential for a board of directors to fundamentally change a Canadian corporation through acquisitions without seeking shareholder approval would be alarming.

7. Is a level of dilution other than that set out in the Amendment more appropriate e.g. 25%, 30%, 40%, 75%, 100%. If so, why?

As noted above, CCGG members believe that 20% is the appropriate level of dilution above which shareholder approval should be required. At most, the dilution limit should be 25% in order to harmonize the requirements for acquiring public and private companies and completing discounted private placements.

It is noteworthy that in *HudBay*, the OSC found that dilution to shareholders of 100% and the resulting economic consequences were both "extreme" and had an "enormous impact" on the rights and economic interests of shareholders.

8. If your response to question 7 is positive, please consider the costs and benefits of requiring security holder approval at such a dilution level. Please explain your responses with reference to the various stakeholders.

As noted above in response to Question #5, although CCGG members acknowledge that there might be additional costs in requiring shareholder approval at lower dilution levels, those costs will not generally be material and are justified to protect the rights of shareholders.

9. Would the 50% dilution proposed in the Amendment provide a bright line test which would obviate the application of Section 603 with respect to public company acquisitions in all but extraordinary circumstances? If not, why not?

In our view, with a threshold as high as 50%, the application of s. 603 would not be limited to extraordinary circumstances. There could be a myriad of ways in which a transaction that results in dilution approaching 50% could be seen to negatively impact the quality of the marketplace within the meaning of s. 603, particularly since the fair treatment of shareholders is a central component of the quality of any marketplace.

However, if the dilution limit is set at a more reasonable 20%, we would agree that it would provide a clear threshold that would limit the need for the TSX to exercise its discretion under s. 603. However, the TSX should clarify that its discretion under s. 603 will only be used to require a shareholder vote where consideration of the factors listed in s. 603 require it, in spite of the fact that dilution is lower than the limit.

The TSX should make it clear that discretionary relief under s. 603 will not be available if dilution is in excess of the limit. It is important to bear in mind that when an application for an exemption is made under s. 603, shareholders who oppose a transaction do not have an opportunity to make submissions. We note that the U.S. exchanges do not have the discretion to grant an exemption to the requirement for shareholder approval if dilution is in excess of 20%.

10. Is it appropriate to permit security holder approval of acquisitions in writing rather than at a meeting? If not, why?

CCGG members agree that it is appropriate for the exemption in section 604(d) of the Manual to apply to shares issued to finance an acquisition, such that an issuer would not be required to hold a meeting if the issuer provided the TSX with written evidence that 50% of shareholders entitled to approve the share issuance have done so, provided that it represents 50% of the equity ownership and not merely 50% control through multiple voting shares.

11. Should security holders have the flexibility to vote on the security holder approval requirements for dilutive acquisitions on an annual basis? Why or why not?

CCGG members do not think that boards should have the right to seek shareholder approval for dilutive transactions in advance on an annual basis with so-called "blank cheque" approval. We agree with the TSX that shareholders should have detailed information about a specific transaction that will dilute their ownership interests prior to being asked to approve it. In addition, the shareholders that authorize a certain level of dilution in advance may not be the same shareholders at the time a specific transaction is contemplated. Since it is the shareholders at the time of the transaction whose economic interests and ownership rights are affected by a dilutive transaction, they should have the right to approve it.

12. What costs and benefits are there in providing such flexibility? Do you agree that the costs outweigh the benefits?

Although advance approval would provide additional flexibility for boards of directors, that flexibility would come at the expense of the shareholders who will bear the economic consequences of a dilutive transaction. As noted above, if investors are not confident that their ownership rights will be respected, they will be less likely to invest in TSX listed issuers. Our members agree that the costs of such an approach outweigh the benefits.

I would be pleased to discuss any aspect of our comments in more detail, or you can contact our Executive Director, Stephen Griggs, at (416) 868-3585.

Sincerely,

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