

# Good Governance Is Good Business



*Corporate Governance  
Policies and  
Proxy Voting Guidelines*

2007



**TEACHERS'**  
PENSION PLAN

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## CORPORATE GOVERNANCE POLICIES

Share ownership carries with it important rights and responsibilities. Share ownership provides the owner with the right to a share of the income of the company and a right to a share of net proceeds on the sale or wind-up of the company. Ownership of a share in the equity of a company also includes the right to sell or transfer that share.

An important right and responsibility of shareholders is to vote their shares. This voting right includes the right to information about the company and the right to express an opinion on the company's performance.

In most public companies today, there is a separation of ownership and control, making it more difficult to pursue the rights to information and to provide feedback. While no one disputes that shareholders own companies, the fact is that management often controls the company. As long as there is a gap between the objectives of management and the objectives of owners, there is a risk that management will act in its own self-interest and possibly to the detriment of the owners.

In pursuing the rights to information and influence, shareholders must keep in mind their responsibilities:

- They must ensure that the obligation to provide information to shareholders does not detract from the company's ability to compete in its marketplace.
- They must also ensure that their right to attempt to influence the company does not translate into behaviour that will paralyse the company. We believe that a company should not be managed by shareholder referendum.
- Shareholders must be careful that their influence will lead to actions that, in the long term, are in the best economic interests of all of the company's shareholders.

## **WHAT IS CORPORATE GOVERNANCE?**

We define corporate governance as “the system by which companies are directed, controlled and evaluated.” Responsibility for corporate governance lies primarily with the board of directors. The role of shareholders and other investors is to appoint directors and to ensure that a proper governance structure is in place. However, good governance is about good practice and not merely about good structure. We must be diligent in evaluating the performance of the directors of the companies whose shares we own to ensure that the governance system is working.

We have developed our *Corporate Governance Policies and Proxy Voting Guidelines* keeping in mind our rights and our responsibilities as fiduciaries acting on behalf of our pension plan’s beneficiaries. It would be inconsistent with our fiduciary responsibility to vote for any management or shareholder-sponsored initiative that we believe is likely to diminish shareholder value over the long term.

Our guidelines are guidelines only. They are not regulations and will evolve as circumstances change. We commit to remain open-minded and pragmatic. We will apply these policies and guidelines with thought and with consideration to the individual circumstances of companies. Actions taken under these guidelines are reviewed with the investment committee of our board of directors at least once a year.

We have adopted the six principles of corporate governance endorsed by the Organisation of Economic Co-operation and Development (OECD) and amplified by the International Corporate Governance Network (ICGN), of which we are members. In Canada, we have been guided by the rules and policies put forth by the Canadian Securities Administrators as well as those endorsed by the Canadian Coalition for Good Governance.

We welcome comments or feedback on our guidelines and encourage you to contact us at [corp-governance@otpp.com](mailto:corp-governance@otpp.com).

## PROXY VOTING

One of our most important rights as investors is the right to vote and to ensure that those votes are cast in a manner that is most consistent with the best economic interests of company shareholders over the long term.

We consider the right to vote to be one of our most effective tools for promoting good corporate governance. We are also obliged by law to set out our policies and procedures with respect to voting rights and by our own *Statement of Investment Policies and Procedures* to exercise our right to vote.

We take the issue of voting very seriously. Our objective is to vote every share of every company we own at every meeting of that company's shareholders. We most often use proxies to exercise our right to vote. A proxy is the legal transfer of a shareholder's right to vote to another party. Proxies allow shareholders who cannot attend meetings in person to exercise their right to vote. We transmit instructions in our proxy on how our vote is to be cast on each of the issues to be addressed at the meeting.

We assess every issue to be considered at every meeting well in advance of the meeting date. In assessing the issues, we review all relevant company filings and other materials we have access to, including proxy research materials provided by our proxy research provider, Glass Lewis & Co. All non-routine issues are highlighted and then reviewed in detail within the context of our guidelines. As appropriate, each of the portfolio managers with an interest in a particular company is surveyed to determine his or her perspective on the issue as it relates to that company. Contentious issues or positions are regularly discussed with the Executive Vice-President, Investments, and the President and Chief Executive Officer. In some instances, we will contact the company directly in an attempt to discuss the proposal, to request a modification of certain aspects of the proposal, or sometimes to seek the withdrawal of the proposal.

We document our reasons for voting for or against all non-routine proposals and disclose this information, well in advance of company meetings, on our website:

[www.otpp.com/proxyvotes](http://www.otpp.com/proxyvotes).

Many types of proposals cannot be classified in advance as favourable or unfavourable. Such a determination will depend on the origin, purpose and effect of the proposal in the specific circumstance. In such cases, we will assess each proposal individually to determine the probable effect on shareholder value and the impact on the rights of shareholders. We will vote in the manner that we believe will best enhance the long-term value of our investments.

When we retain external investment managers, we delegate to those managers the authority to vote at shareholder meetings in respect of stock managed on our behalf, and instruct them to be guided by our proxy voting guidelines in casting their votes. We reserve the right to retract voting rights in respect of any given company. Each quarter we receive a report from these managers indicating how they voted in that quarter.

## **SOCIAL RESPONSIBILITY**

Our fiduciary duty requires us to obtain the highest return for the plan within acceptable levels of risk. Consequently, non-financial considerations cannot take precedence over risk and return considerations in the management of the pension fund.

Nevertheless, we believe that careful consideration of social responsibility issues by companies and their boards will enhance long-term shareholder value. We encourage companies to develop policies and practices to address issues of social responsibility that are relevant to their businesses, including:

- the environmental impact of the company's products and operations;
- the impact of the company's strategies and decisions on the communities and constituencies directly affected by its products and operations;
- fair labour practices for all segments of the population; and
- employee training and development.

These are some of the criteria we take into consideration as part of our regular investment process, as we have found that the companies that ignore these responsibilities are less likely to be successful in the long term. Our attention to these issues is not meant to be a substitute for the duties and actions that are the responsibility of regulatory agencies or the laws of the country in which a company operates.

Our focus is to obtain the highest return and to encourage the adoption of socially responsible policies and practices by companies as a means of maximizing long-term shareholder value.

# Proxy Voting Guidelines



## PROXY VOTING GUIDELINES

The following guidelines describe how we intend to vote on some commonly raised or potentially contentious issues. These guidelines have been developed with a view to encouraging companies to take actions that, in the long term, are in the best economic interest of shareholders. We apply these guidelines to help determine whether to support or oppose a proposal by a corporation (or shareholder), such action having been placed before all shareholders for a vote.

Since we vote Canadian, U.S., and international proxies, our guidelines deliberately cover a broad range of corporate governance matters, a number of which may not arise in Canada for regulatory reasons or because of the different size and composition of the Canadian corporate community.

## 1. **BOARDS OF DIRECTORS**

The board of directors represents the shareholders and, as such, ought to play the most significant role in corporate governance at any company. We believe that a board has three overriding responsibilities:

- determining direction and strategy
- exercising control
- evaluating performance and succession planning

In order to discharge these responsibilities adequately, boards must organize themselves to constructively challenge management's recommendations and to evaluate corporate performance from an objective perspective.

We, as investors, are often asked to consider resolutions that would place additional constraints on the composition or conduct of the board; for example, proposals placing age or term limits on directors or imposing diversity criteria on the nominating process. While we empathize with the spirit of many of these proposals and we commit to evaluate each on a case-by-case basis, we do not generally support them. We believe that a properly constituted board should address these issues in the normal course of fulfilling its responsibilities, and that a board generally requires the freedom and flexibility to organize in the manner that is best for the individual company.

The guidelines described here are each designed to encourage the board of directors to discharge its responsibilities in the most efficient and objective fashion possible, without placing unreasonable burdens on the company or conduct of the board.

## 1.1 INDEPENDENT BOARDS OF DIRECTORS (revised)

### GUIDELINE

We *support* an independent board of directors. Ordinarily, we will not vote against a corporation's director candidates simply because they fail to meet the independence standard. We will do so, however, if corporate performance, over a reasonable period of time, is unsatisfactory.

### DISCUSSION

A board of directors should have a majority of independent directors and ensure that the board is truly independent of management.

In determining whether a director is independent, we look to the standards in National Instrument 58-101 of the Canadian Securities Administrators, *Disclosure of Corporate Governance Practices*, and the corporate governance listing standards of the New York Stock Exchange. Under these standards, a director is independent if he or she has no direct or indirect material relationship with the issuer or a parent company or subsidiary of the issuer. A "material relationship" is a relationship which could, in the view of the issuer's board, reasonably interfere with the exercise of a director's independent judgement, though shareholding alone is not necessarily considered to constitute such a relationship.

There are circumstances where directors may be presumed to have a material relationship with an issuer. For instance, executives or employees who have retired from the company within the previous three years, relatives of management, and directors receiving consulting fees, such as legal counsel and investment bankers, would generally not be considered to be independent. Those who have interlocking directorships, whereby chief executive officers sit on each other's boards, would also not be considered to be independent directors. We prefer that the company disclose, for each member of the board and the chief executive officer (CEO), the identity of each company where an interlocking relationship exists.

We believe that a board with a majority of independent directors, and whose key committees are staffed with independent directors, is better positioned to critically evaluate management and corporate performance. The key committees are the audit committee, the nominating/governance committee, and the compensation committee.

## 1.2 THOROUGH NOMINATION AND PERFORMANCE REVIEW PROCESS

### GUIDELINE

*We support the establishment of an independent nominating/governance committee. We will not ordinarily vote against directors simply because the board lacks a properly constituted nominating/governance committee. We will do so if corporate performance, over a suitable time frame, is unsatisfactory.*

### DISCUSSION

A strong board composed of qualified directors should enhance corporate performance. The board's process for identifying, recruiting, nominating, appointing, and orienting new directors, and for assessing existing directors, is central to ensuring the qualifications of the board.

Each board should have an independent nominating/governance committee comprised of independent directors. The nominating/governance committee should set the policy for selecting qualified candidates, propose new nominees to the board, and assess directors on an ongoing basis. This committee should also be involved in the assignment of responsibilities and personnel to the board's other committees. Finally, this committee should encourage the adoption of a self-assessment process for the entire board of directors as well as its committees. The fact that such assessments are undertaken should be disclosed, as well as attendance records and the number of other boards that each director sits on. This allows shareholders to assess for themselves the effectiveness of each board member.

## 1.3 ELECTION OF DIRECTORS (new)

### GUIDELINE

We *support* the establishment of a majority-vote standard for the election of directors. We also *support* the election of directors individually rather than as a slate. We will not ordinarily vote against the board candidates proposed by a corporation simply because the corporation fails to meet these standards.

### DISCUSSION

Teachers' prefers and encourages companies to design proxy structures that give shareholders the ability to vote for or against individual board nominees, rather than requiring them to vote for or against an entire slate of board nominees. In permitting such structures, we believe that companies should adopt a majority-vote standard for the election of directors, meaning that directors are elected by a majority of votes cast by shareholders. We understand that majority voting may not be practical in contested elections where there are more director nominees than board seats, and therefore accept the use of the plurality standard in these circumstances. Under the plurality voting standard, a board nominee is elected by receiving the highest number of votes cast even if less than a majority.

## 1.4 INDEPENDENT AUDITORS

### GUIDELINE

We *support* the establishment of an independent audit committee. We also generally *support* the choice of auditors recommended by the corporation's directors, specifically by the audit committee of these directors. The instances of auditors being changed other than as a result of routine rotation will be reviewed on a case-by-case basis.

### DISCUSSION

A strong audit process is a necessary condition of good governance and should enhance corporate performance. The audit process involves the establishment, structure, and composition of an audit committee and the retention of an auditor or auditors. Each board should have, and indeed is required to have, an independent audit committee composed of independent directors, each of whom is financially literate.

The role of the auditor is central to the audit committee's ability to fulfill its responsibilities. Our preference is that the audit committee retains the services of a well-known and reputable accounting firm. We also prefer that all, or a significant majority, of the revenues generated by the accounting firm through its relationship with the company come from the audit function. We would be concerned if the same firm and, in particular, the same partner of any firm, has audited a company for excessively long periods or if there have been material restatements to the financial statements. In these circumstances, we may withhold our support from the auditor.

## 1.5 NON-AUDIT FEES COMPROMISE INDEPENDENCE

### GUIDELINE

A significant majority of revenues generated by the accounting firm through its relationship with the company should come from the audit function proper. Where there is no disclosure, or a breakdown of the fees and the non-audit fee is greater than the audit fee without further clarification, we will not support the re-election of the outside auditor.

### DISCUSSION

We are committed to the principle of the independence of external auditors and we have accordingly recognized these principles within our own proxy voting guidelines. Shareholders must be able to rely on the independent auditor. If they perceive that there is a lack of independence, whether or not such a deficiency exists, much of that value is lost.

In 2002 the *Public Company Accounting Reform and Investor Protection Act of 2002* also known as the “*Sarbanes Oxley Act*” imposed the disclosure of all audit versus non-audit fees, and in 2004 the Ontario Securities Commission did the same. The *Sarbanes Oxley Act* also identified certain non-audit functions that were deemed to be incompatible with external auditor independence. Eight specific functions are now strictly prohibited in the U.S. on the grounds that they impair the independence of the external auditor. These are:

- bookkeeping or other services related to the accounting records or financial statements of the audit client;
- financial information systems design and implementation;
- appraisal or valuation services, fairness opinions, or contribution-in-kind reports;
- actuarial services;
- internal audit outsourcing services;
- management functions or human resources consulting;
- broker or dealer, investment advisor or banking services;
- legal or expert services unrelated to the audit.

Where non-audit fees have been detailed, we will consider each fee on a case-by-case basis in determining auditor independence, but we will not support the reappointment of the auditor where it appears that its independence has been compromised.

## 1.6 COMPENSATION REVIEW PROCESS

### GUIDELINE

*We support the establishment of an independent compensation committee. We will not ordinarily vote against a corporation's director candidates simply because the board lacks a properly constituted compensation committee. We will do so if corporate performance, over a suitable time frame, is unsatisfactory.*

### DISCUSSION

Each board should have a compensation committee comprised of independent directors, at least one of whom has expertise in compensation matters. On a reasonable and periodic basis, the compensation committee should evaluate whether new and existing compensation packages are properly structured to enhance shareholder value and whether the incentives are commensurate with performance. Any consultants engaged by this committee should only be responsible to the members of the committee. Our preference is that the compensation committee retain the services of well-known and reputable consultants and that the identity of such consultants and the nature and amount of all compensation services be disclosed. The members of this committee should not be nominated or selected by the CEO.

A strong and independent compensation committee will work to ensure that the incentives to the CEO, management, and other employees are consistent with the maximization of long-term shareholder value, and that the rewards are commensurate with performance.

## 1.7 SIZE OF BOARDS OF DIRECTORS: 5 TO 16 MEMBERS

### GUIDELINE

We *support* a board size of 5 to 16 members. We will not ordinarily vote against a corporation's director candidates simply because the size of the board is outside the guideline. We will do so if corporate performance, over a suitable time frame, is unsatisfactory.

### DISCUSSION

Directors are elected to promote and protect shareholders' interests. A board that is too large will dilute the voting power of individual members and may reduce the effectiveness of the board. On the other hand, a board that is too small may not be able to adequately discharge its responsibilities, to the detriment of overall corporate performance.

There must be a sufficient number of board participants to enable the board to function efficiently and effectively. The key areas that must be examined in conjunction with the size of a board in order to ensure board effectiveness are:

- the ability to secure critical resources for the company through networking;
- the quality of advice and counsel available when a board has a diverse composition;
- sufficient composition to ensure that management will not exert undue influence;
- the composition of committees and the specialty required for committee duties;
- diversity in experience, education, attitudes and background.

Board effectiveness is central to maximizing long-term shareholder value. The board must be large enough to allow it to adequately discharge its responsibilities, without being so large that it becomes cumbersome. Problems of poor communication and decision-making will overwhelm boards where the composition is too large.

We prefer a board of no fewer than five and no more than 16 members depending on the type of corporation. However, the board's top priority should be to ensure that it has enough competent and independent members, regardless of size.

## 1.8 CUMULATIVE VOTING FOR DIRECTORS

### GUIDELINE

We will review cumulative voting proposals on a *case-by-case* basis, voting for such proposals when they ensure an independent voice on an otherwise unresponsive board of directors.

### DISCUSSION

Cumulative voting entitles shareholders to as many votes as the number of shares they own multiplied by the number of directors to be elected. These votes may then be used as the shareholder wishes to vote for a single candidate, or any or all candidates.

Cumulative voting allows for the possibility that a minority block of shares can be represented on a board, ensuring an independent voice at the boardroom table, but also allows for the possibility that a minority of shareholders could unduly influence the company.

Opponents to cumulative voting are concerned that directors who gain office as a result of cumulative voting might be preoccupied with their own agenda or the agenda of special interest groups rather than the welfare of all shareholders. Proponents of cumulative voting see it as an effective method of gaining minority representation on the board and of ensuring that the board is somewhat independent of management.

## 1.9 CLASSIFIED OR STAGGERED BOARDS

### GUIDELINE

We prefer the annual election of all directors. We will generally *not support* proposals that provide for staggered terms for board members.

When a proposal to adopt staggered terms for directors has been approved by a vote of shareholders, we will generally *support* the directors who are standing for staggered terms in those instances in which a vote for such directors is viewed to be in the financial interest of the shareholders and in conformity with the guidelines for the election of directors. We do not believe it is appropriate to vote against such directors simply as an indication of disagreement with the manner in which directors are elected.

### DISCUSSION

In a classified or staggered board, directors are typically elected in two or more classes, serving terms greater than one year. Using an example of a three-year staggered board, at each annual meeting, one third of the board members or nominees would be eligible for shareholder ratification for a three-year period.

Proponents of classified boards argue that by staggering the election of directors, a certain level of continuity and skill is maintained. It is worth noting that this continuity can also be maintained with a policy of annual elections, if the directors are careful to address the issues of competence and succession.

We see many disadvantages with a classified system. Staggered terms for board members make it more difficult for shareholders to make fundamental changes to the composition and behaviour of boards, by making it extremely difficult for any challenge to, or change in, board control. In circumstances of deteriorating corporate performance, this difficulty could result in a permanent impairment of long-term shareholder value.

## 1.10 SEPARATION OF BOARD AND MANAGEMENT ROLES (revised)

### GUIDELINE

We *support* the separation of board and management roles. We will not ordinarily vote against a corporation's director candidates where there does not exist a separation of board and management roles. We will do so if corporate performance, over a suitable time frame, is unsatisfactory.

### DISCUSSION

The Chair of the Board is responsible for co-ordinating the activities of the board, which, in turn, is responsible for evaluating the performance of the company and its CEO. The CEO is responsible for the day-to-day operations and management of the company. We believe that these responsibilities put a combined Chair/CEO in the very difficult position of co-ordinating the body that is responsible for evaluating his or her own performance. We are also concerned that, in these situations, too much power or control may reside in one individual.

For these reasons we believe it is appropriate, in most instances, to separate the roles of Chair and CEO. We believe there is a great potential advantage to the corporation, the CEO, and the directors to have a separate Chair, who can deal with matters from the board's point of view, and who can provide a greater measure of independence to the board's oversight role. While we prefer the separation of the roles, we recognize that in some circumstances, it may be justified that the roles be combined. When this is the case, we believe it is appropriate that the reasons be stated so that shareholders can judge for themselves the appropriateness of a combined Chair and CEO role.

In situations where the same person holds the Chair and CEO titles, we advocate the practice of appointing a "Lead Director" for the board. We note, however, that any standard description of the role and responsibilities of a Lead Director is almost indistinguishable from the role and responsibilities of an independent and non-executive Chair.

## 1.11 DIRECTOR LIABILITY AND INDEMNIFICATION

### GUIDELINE

We will generally *support* proposals that limit directors' liability and provide indemnification, subject to the qualifications outlined below.

### DISCUSSION

We recognize that corporate directors might be more sensitive to shareholders' concerns if they were to be subject to personal liability in the event of a successful suit by a shareholder. However, we also believe that many individuals would be reluctant to serve as corporate directors if they were to be personally liable for all lawsuits and legal costs. Limitations on directors' liability can benefit the corporation and its shareholders by facilitating the attraction and retention of qualified directors and officers while affording recourse to shareholders on areas of misconduct by directors.

Consequently, in order to encourage the nomination of able directors, we believe that an appropriate indemnification policy is warranted. However, these policies should be generally limited to the director acting honestly and in good faith with a view to the best interests of the corporation and, in criminal matters, limited to the director having reasonable grounds for believing the conduct was lawful.

## 2. MANAGEMENT AND DIRECTOR COMPENSATION

Complex management and director compensation plans have become more prevalent in recent years. We believe that each compensation plan must be reviewed in its entirety to determine if the individual parts serve the purpose of providing the right incentives to managers and directors and if the plan is reasonable on the whole.

Compensation and incentives to management and directors should be consistent with the long-term interests of the shareholders of the company. Salaries should reflect the requirements of the marketplace with employees paid the amount necessary to attract and retain the skills and abilities required. All perquisites should reflect a justifiable corporate need and should be able to stand on their own merits under a cost-benefit analysis. Incentive compensation plans must have the overriding purpose of motivating and retaining individuals and must not be unduly generous. Such plans should be closely related to individual and corporate performance.

One of the most complex and contentious components of many incentive compensation plans is the use of equity incentives to motivate senior and middle managers. We are not opposed to the use of equity incentives to motivate managers; however, we are concerned that equity plans are sometimes poorly designed and administered or abused.

Equity compensation plans require a high level of scrutiny and disclosure:

- *Expense equity compensation in financial statements.* Generally Accepted Accounting Principles, or GAAP, in Canada and the United States, require public companies to expense the value of the equity incentives granted during the year.
- *Tie equity incentives to performance.* Many equity plans in existence today base rewards on general market or sector performance rather than on individual company out-performance of the market or sector. We would prefer to see that the exercise price or the vesting schedule of the equity incentive be linked to the achievement of appropriate, company specific, performance or profit thresholds.

Alternatives to stock options include stock appreciation acquisition rights, or SARs, phantom stock, restricted stock plans, and deferred share units. SARs are similar to stock options, except that when the rights are exercised, the grantee receives a cash payment rather than shares. Phantom stock plans often take the same form; instead of payment being made in shares, payment is made in cash having a value equal to the value the underlying shares would have had. Restricted stock plans are awards of shares that have holding period restrictions, often vesting over a period of five years or more. Deferred share units are not actual shares, but units which derive their value from the value of underlying shares. Their value is received in shares or cash upon the manager's or director's retirement from the board or the company, as the case may be. Whereas stock options have value only when the market price is above the exercise price at the time of exercise, restricted stock and deferred share awards have a value that varies directly with the price of the underlying stock and is virtually always greater than zero.

## 2.1 EFFECTIVE EQUITY COMPENSATION (revised)

### GUIDELINE

We assess proposed equity compensation on a *case-by-case* basis. We review the features of each plan together with the other aspects of total compensation and, after considering each of the issues, determine whether the plan on the whole is reasonable.

### DISCUSSION

Equity compensation plans can increase the number of shares of a company and therefore dilute the value of existing shares. While such plans can be an effective compensation tool in moderation, they can be a concern to shareholders and their cost needs to be closely watched. We look to support equity compensation plans with some or all of the following features:

- Total potential dilution is less than 10% and ideally below 5%. We will consider total potential dilution above 10% only in certain limited circumstances.
- The “burn rate” – the number of equity incentives granted in a given year expressed as a percentage of shares outstanding – is restricted to less than 1% of the shares outstanding (or 20% of the equity incentives available under the plan).
- There are specific performance criteria for the award of equity compensation or the vesting of equity compensation already granted.
- Options and SARs granted have a maximum life of five years.
- Equity compensation does not vest immediately and vests over the life of the plan.
- Directors do not have the flexibility to set the terms of the equity compensation to be granted without shareholder approval or modify the terms of equity compensation already granted.
- There are strict limits placed on the director’s ability to participate in the plan, and in particular, there is a specific and objective formula for the award of director equity compensation.
- There is not an overly strong concentration of equity compensation granted to senior executive(s).

*Form of Vehicle:* We will review the granting of stock options, stock appreciation rights, phantom shares and restricted stock on a *case-by-case* basis.

*Price:* We will generally *support* plans whose underlying securities are to be issued at a value that is no less than 100% of the current market value.

*Re-pricing:* We will *not support* plans that allow the board of directors to lower the exercise price of options and SARs already granted. We will *not support* proposals that, directly or indirectly, would reduce the exercise price of incentives already granted.

*Expiry:* We will generally *support* plans whose equity incentives have a life of no more than five years. We will review on a *case-by-case* basis those plans whose equity incentives have a life of more than five years but we will generally *not support* plans with “evergreen” provisions.

*Dilution:* We will generally *support* equity incentive plan amendments if the total potential dilution does not exceed 5%, and the so-called “burn rate” is less than 1% per annum. We will review, on a case-by-case basis, equity incentive plans that provide for total potential dilution exceeding 5% but less than 10%, or where the “burn rate” exceeds 1% per annum. Where warranted and in limited circumstances, we will consider supporting equity incentive plan amendments with potential dilution rates exceeding 10%, or where the “burn rate” exceeds 2% per annum.

*Vesting:* We will generally *not support* plans that are 100% vested when granted.

*Performance Vesting:* We will generally *support* plans that link the granting of equity incentives, or the vesting of equity incentives previously granted, to specific performance targets.

*Concentration:* We will generally *not support* plans that authorize allocation of 25% or more of the available equity incentives to any one individual.

*Director Eligibility:* We will generally *support* equity incentive plans for directors where the terms and conditions of director incentives are clearly defined and are reasonable. In particular, we look for a specific and objective formula for the award of director equity incentives. We will generally *not support* those plans that provide for discretionary director participation.

*Change of Control:* We will *not support* plans with change of control provisions if the provisions allow all equity compensation to automatically vest upon a change of control. We will *not support* change of control arrangements developed in the midst of a takeover fight specifically to entrench management. We will *not support* the granting of equity incentives or bonuses to outside directors “in the event” of a change of control as the independence of outside directors will be compromised if they are eligible for additional severance benefits in the event of a change of control.

*Fixed Number of Shares:* We will generally *not support* plans that do not express as a fixed number the maximum number of shares that can be subject to options or other forms of equity compensation.

*Board Discretion:* We will *not support* plans that give the board broad discretion in setting the terms and conditions of programs. Such programs must be submitted to shareholders with adequate detail regarding their cost, scope, frequency and schedules for exercising the equity incentives.

*Employee Loans:* We will generally *not support* the corporation making loans to employees to allow employees to pay for equity compensation. Excessive loans expose the company to risk as a result of potentially uncollectable debts and may inhibit the termination of employees who are in debt to the company. Executives seeking to buy equities under equity compensation plans should be encouraged to obtain credit from more conventional, market-rate sources, such as banks or company credit unions.

*Omnibus Plans:* We will generally *not support* omnibus plans (three or more types of awards in one plan). We believe that shareholders should vote on the separate components of such plans rather than be forced to consider the “take-all” approach of an omnibus collection. Although we are opposed to the concept of omnibus plans, we will review each element to determine whether the specific benefits being offered are contrary to our other guidelines in this category.

*Disclosure:* We strongly *support* the expensing of foregone equity compensation premiums in a company’s income statement, together with detailed footnote disclosure of costs associated with the equity compensation plan.

## 2.2 MANAGEMENT COMPENSATION

### GUIDELINE

We will review management compensation plans on a *case-by-case* basis. We review the features of each plan and determine whether the plan on the whole is reasonable.

### DISCUSSION

Companies are facing increasing pressure to provide meaningful justification for their compensation policies. We look to support compensation plans with some or all of the following features:

- clear statement by the board of directors of its executive compensation philosophy and how this philosophy is related to the company's strategic objectives;
- incentives for performance that address both short- and long-term corporate objectives that we believe will be stable and not require alteration through the company's business cycle;
- a minimum one-year post-retirement hold period, although we prefer two years;
- minimum share ownership requirements;
- meaningful industry and company performance metrics for both the awarding and vesting of incentives;
- full disclosure of all benefits including the present value of pension benefits and supplemental executive retirement plans in the compensation table in the management information circular;
- identification of changes in philosophy or performance targets.

## 2.3 DIRECTOR COMPENSATION

### GUIDELINE

We will generally *support* proposals that call for a certain percentage of directors' compensation to be in the form of common stock (or restricted share units). We will not ordinarily vote against directors where there does not exist a practice of paying some percentage of director compensation in common stock. We will do so if corporate performance, over a suitable time frame, is unsatisfactory.

### DISCUSSION

Individual directors should be appropriately compensated and should be motivated to act in the best interests of shareholders. We believe that share ownership by directors better aligns their interests with those of other shareholders. For this reason, we believe that meaningful share ownership by directors is in the best interest of the company.

We believe that the degree of ownership should be determined by the circumstances of that individual director's financial position but that the financial commitment should be material to that director. As a minimum guideline, we suggest that each director should own an amount of stock at least equal in value to one year's compensation as a board member.

We also encourage boards to adopt a policy of paying a percentage of directors' compensation in the form of common stock, which the directors undertake to hold so long as they remain directors of the company.

## 2.4 SEVERANCE COMPENSATION (revised)

### GUIDELINE

We will review severance compensation arrangements on a *case-by-case* basis. We will *not support* “golden parachutes” that we deem to be excessive or that are “single trigger” arrangements.

### DISCUSSION

A “golden parachute” is a severance compensation arrangement, to be paid to an employee whose employment is terminated. In some cases the payment is contingent upon the merger or acquisition of the corporation with a resulting change of control. These benefits can take the form of severance pay, a bonus, vesting of equity compensation, or a combination thereof.

Single trigger “golden parachute” arrangements are those that typically require only that a change of control occurs or is deemed to have occurred, and not that the individual also loses his or her job or has his or her responsibilities curtailed not of their own volition. Double trigger arrangements require both a change of control and that the individual ceases to be employed in a manner that is similar or reasonably comparable to his or her current role. Payment of reasonable severance compensation is justified when job loss or significant demotion occurs, but is not acceptable when it is excessive and/or in circumstances where the individual continues to be employed in the same or similar capacity as he or she was prior to the trigger event occurring.

We recognize the need for competitive severance arrangements, particularly to enable management to continue making decisions in the best interests of a company and its shareholders regardless of their own welfare in the event of a successful takeover.

However, such “golden parachutes” are often excessive and serve to entrench management and benefit only that entrenched management.

### 3. TAKEOVER PROTECTION

Our fiduciary duty requires us to vote in a manner that we believe will enhance the long-term value of our investments. We will look at take-over protection measures on an individual basis with this principle in mind. We recognize that take-over protections, when properly used, may optimize shareholder value, but they must not unduly deter initial unsolicited bids or follow-on offers. While take-over protection measures must strike a balance between targets and bidders, in our view they must primarily serve the interests of long-term shareholders.

#### 3.1 SHAREHOLDER RIGHTS PLANS

##### GUIDELINE

We will review shareholder rights plans on a *case-by-case* basis. We will generally *not support* shareholder rights plans that go beyond ensuring equal treatment of shareholders in the event of a bid, and allowing the company sufficient time to consider alternatives to a bid.

##### DISCUSSION

A “shareholder rights plan” provides the shareholders of a target company with rights to purchase additional shares or to sell shares at very attractive prices, in the event of an unwanted offer for the company. These rights, when triggered, impose significant economic penalties on a hostile acquiror.

In the U.S., a shareholder vote on the enactment of a shareholder rights plan is not required and boards generally adopt these plans without shareholder votes. This has made the use of these plans quite contentious. In Canada, corporations are required to submit shareholder rights plans to shareholders no later than the annual meeting following the adoption of the plan. These plans are still quite controversial in Canada, but shareholders have some comfort in knowing that any plan must be brought before shareholders for ratification.

There are two legitimate purposes of a shareholder rights plan: 1) ensuring that all shareholders are treated equally in connection with a change of control of the company; and 2) allowing the board of the target company sufficient time to determine whether there is a course of action that will provide shareholders with a better alternative to the offer.

In Canada, the regulatory and legislative environment attempts to address each of the two legitimate purposes of shareholder rights plans. However, we believe that the current legislation and regulatory policies often do not go far enough. We also believe that improved legislation and regulation would reduce and perhaps eliminate the need for companies to adopt shareholder rights plans.

For this reason, we will look to support shareholder rights plans with all or substantially all of the following features:

- The plan provides that the minimum bid period is not longer than 60 days.
- The plan allows for partial bids.
- The plan does not authorize the board to waive the plan's application unless the plan is waived for all other subsequent bids.
- The plan does not allow for the redemption of rights without shareholder ratification.
- The plan does not contain exemptions for private placements.
- The plan exempts soft lock-up agreements.
- The plan requires shareholder ratification at least every three years.
- The plan places a modest limit on the granting of any "break fees."

## 3.2 “GOING PRIVATE TRANSACTIONS,” “LEVERAGED BUYOUTS” AND OTHER PURCHASE TRANSACTIONS

### GUIDELINE

We will evaluate going private transactions, leveraged buyouts and other purchase transactions on a *case-by-case* basis, but we will *not support* transactions that do not adequately compensate minority shareholders.

### DISCUSSION

“Going private transactions” involve proposals by a company, on behalf of a controlling shareholder, to purchase all of the shares held by minority shareholders of the company.

A “leveraged buyout” is most often a proposal to buy a company by a group of financial buyers that includes and is supported by the management of the company.

In one sense, going private transactions and leveraged buyouts are simply offers to acquire all of the shares of a company by an interested party. These two circumstances, however, are complicated by the fact that the offering party is usually an insider, either the controlling shareholder or the management of the company. Both of these parties may have an informational advantage over minority shareholders.

Whenever a publicly traded corporation seeks to become privately owned via a “going private transaction” or a “leveraged buyout,” we will carefully evaluate the proposal to determine whether the transaction is in the long-term best economic interests of shareholders or whether it is designed mainly to further the interests of one group of stakeholders at the expense of other shareholders.

In addition to such an economic analysis, we will review the process by which the proposal was received. In this regard, we will consider whether:

- Other potential bidders have had an opportunity to investigate the company and make competing bids; and
- A valuation and/or “fairness opinion” has been obtained from a qualified and independent party, and the analysis and recommendations contained in that valuation or opinion support the proposal.

### 3.3 “LOCK-UP” ARRANGEMENTS

#### GUIDELINE

While we will evaluate potential arrangements on a *case-by-case* basis, we will generally *not support* “hard” lock-up arrangements if these arrangements serve to prevent competing bids for a corporation in a takeover situation.

#### DISCUSSION

“Lock-up” arrangements are agreements between certain shareholders to sell their shares to a potential acquiring company before a formal offer is made to other shareholders. The commitment to sell is often negotiated without the knowledge or involvement of the company, its management, or its board. Potential acquirors seek lock-up arrangements to ensure that a minimum number of shares at a set price will be tendered under an offer and to discourage other potential bidders.

Lock-up agreements are often classified as “hard” or “soft” depending on how difficult it will be for the selling shareholder in the lock-up agreement to extricate itself from the commitment to sell. The harder the lock-up agreement, the less likely it is that the selling shareholder would be free to sell its shares to a competing offer. A hard lock-up agreement may discourage a third party from making a competing offer.

Proponents of lock-up arrangements argue that there may be cases where a lock-up arrangement is required to give the potential acquiror sufficient confidence to undertake to bid. Proponents also point to the fact that the right to dispose of one’s securities in the manner most appropriate to one’s interests is one of the fundamental rights of share ownership.

We respect this and so do not disagree with lock-up agreements as a matter of principle. However, lock-up agreements are in the best interests of all shareholders only if the agreement clearly provides the possibility of achieving the best value in the long term for all shareholders. Generally, such clarity comes only after management and the board have exhausted all other alternatives, and generally, this requires that the company is able to solicit and respond to competing offers for the company.

## 3.4 “CROWN JEWEL” DEFENCES

### GUIDELINE

We review transactions on a *case-by-case* basis. We will generally *not support* crown jewel defences unless they are clearly in the interests of all shareholders.

### DISCUSSION

“Crown jewel” defences involve the selling of assets to a friendly third party to frustrate an attempted takeover. Crown jewel defences can be used to frustrate takeover bids and may result in the sale of assets at less than their fair value, both of which are potentially detrimental to the interest of shareholders, and may undermine shareholders’ rights to determine the company’s future course of action.

In Canada, such transactions usually require the approval of a majority of the shareholders. In addition, if a transaction comprises “substantially all the assets of a corporation” or if the transaction “would change the essential nature of a corporation’s business,” dissent rights are granted to shareholders. Dissenting shareholders may seek a court-supervised appraisal of the “fair value” of their shares and may demand a cash payment of that amount from the acquiror.

### 3.5 PAYMENT OF “GREENMAIL”

#### GUIDELINE

We will *support* proposals that seek to prevent the payment of “greenmail” to an unwanted purchaser of the corporation. We will *not support* the payment of “greenmail.”

#### DISCUSSION

“Greenmail” is the payment from corporate funds of a premium price to selected shareholders (often an unwanted purchaser of a company) without the opportunity for all shareholders to participate in such a purchase program. Because these purchases are usually done at a price above the then-current market price of the company’s stock, there is transfer of value from the company to one shareholder or group of shareholders, placing the remaining shareholders at an economic disadvantage.

Anti-greenmail resolutions generally require shareholder approval of a major share repurchase at prices that exceed the market, unless the same purchase price is offered to all of the corporation’s owners.

## 3.6 FAIR PRICE AMENDMENTS

### GUIDELINE

We will *support* proposals that require a bidder for a corporation to pay every shareholder a fair price where a “fair” price is defined as the highest price paid to any shareholder under the offer.

### DISCUSSION

Fair price provisions require a bidder to pay the same “fair” price for all shares purchased. The “fair price” is usually defined as the highest price paid by the bidder for shares acquired before the start of the tender offer.

Fair price provisions were designed to help guard against two-tiered tender offers, in which an offeror offers a substantially higher cash bid for an initial and often controlling stake in a company and then offers a lower price for the remaining shares. In Canada, two-tiered tender offers are effectively prohibited, making fair price provisions unnecessary, but the same protections do not exist in some other jurisdictions.

## 3.7 REINCORPORATION

### GUIDELINE

We will *support* reincorporation proposals when management and the board can demonstrate sound financial or business reasons for the move. However, we will generally *not support* reincorporation proposals that are made as part of an anti-takeover defence or solely to limit directors' liability.

### DISCUSSION

Reincorporation involves a proposal to re-establish the company in a different legal jurisdiction. There are a number of legitimate reasons why a company may want to reincorporate, but it is often a tactic by management to frustrate a potential takeover or to limit director liability.

## 4. SHAREHOLDERS' RIGHTS ISSUES

### 4.1 CONFIDENTIAL VOTING BY SHAREHOLDERS

#### GUIDELINE

We will *support* resolutions to introduce confidential voting.

#### DISCUSSION

Voting at annual, general and special meetings should be subject to the same safeguards as voting in any other election and should be free of any potential for coercion. Confidential voting procedures ensure this freedom and have not been particularly expensive or difficult to implement where companies have adopted them. Open balloting, on the other hand, creates the opportunity for coercion or re-solicitation. We do not object to disclosure of our own voting practices and, in particular, when voting against a proposed resolution, will so advise a company's management. We support the prompt disclosure of the voting results of each proposal voted on at a meeting of shareholders.

## 4.2 DUAL-CLASS SHARE STRUCTURES (revised)

### GUIDELINE

We *support* one class of shares. We will generally *not support* the creation or extension of dual-class share structures.

### DISCUSSION

Dual-class share structures involve the creation of a second class of common stock with either superior or inferior voting rights to those of the existing class of stock. The shares that have inferior voting rights sometimes pay a greater dividend and can usually be transferred more readily than the shares that have superior voting rights. To the extent that shareholders opt for the lower voting shares, management, or certain shareholders, maintain effective control of the corporation by keeping for themselves the shares that have superior voting rights. Other forms of unequal share structures include those that allow a certain class of shareholders to elect a disproportionate share of directors.

Dual-class share provisions create a “second class” of common shares in every sense of the term. Such proposals allocate voting rights in a manner that is not consistent with economic ownership, thus depriving some shareholders of certain rights and controls. Dual classifications with unequal voting rights violate the principle of “one share, one vote,” leading to the possibility that the company may take actions or fail to take actions without the support of a true majority of shareholders.

While we do not support the creation of dual class share structures, we understand that this structure does exist in many corporations. In these cases, it is important that the share provisions allow for fair and equitable treatment of both classes of shareholders, which we will assess on a case-by-case basis.

## 4.3 SUPERMAJORITY APPROVAL OF BUSINESS TRANSACTIONS

### GUIDELINE

We will review supermajority proposals on a *case-by-case* basis; however, we will generally *not support* proposals in which management seeks to increase the number of votes required on an issue above two-thirds (66.7%) of the outstanding shares.

### DISCUSSION

Supermajority amendments are generally designed to deter hostile takeovers by imposing artificially high voting barriers. They typically require the approval of three-quarters (75%) or more of shareholders for a particular transaction.

We agree that in some circumstances a supermajority approval is appropriate; however, we feel that in these circumstances a two-thirds (66.7%) approval level is sufficient. Such a vote requirement, in our opinion, is reasonable and yet provides sufficient protection against unwarranted invasions on the corporation. This threshold also has some support using corporate law as a precedent.

## 4.4 INCREASE IN AUTHORIZED SHARES (revised)

### GUIDELINE

We will generally *support* proposals for the authorization or issuance of additional shares provided the amount requested is necessary for sound business reasons. We will generally *not support* proposals that seek to increase the authorized or issued shares by 25% or more when management does not demonstrate a specific and valid need.

### DISCUSSION

An increase in the number of authorized or issued shares provides a company's board of directors with flexibility to meet changing financial conditions. Additional shares may be needed to:

- implement a stock split, which can expand and improve the market for the company's securities;
- aid in a restructuring or acquisition, which can improve the company's competitive position;
- provide sufficient shares for use in stock option or other executive compensation plans; or
- implement a shareholder rights plan or other takeover defence.

We believe that control should be exercised over authorized shares and the issuance thereof to allow shareholders to have input on major decisions that affect the company.

## 4.5 “BLANK-CHEQUE” PREFERRED SHARES

### GUIDELINE

We will generally *not support* either the authorization of, or an increase in, blank-cheque preferred shares.

### DISCUSSION

“Blank-cheque” preferred shares usually carry a preference as to dividends, rank ahead of common shares upon liquidation, and give a board broad discretion (a “blank cheque”) to establish voting, dividend, conversion and other rights in respect of these shares.

Blank-cheque preferred shares might provide corporations with the flexibility needed to meet changing financial conditions. They may also be used as a vehicle for a defence against hostile suitors, or may be placed in friendly hands to help block a potential takeover bid. A concern for many shareholders is that once these shares have been authorized, shareholders have no further power to determine how or when these shares will be designed and allocated.

## 4.6 SHAREHOLDER PROPOSALS

### GUIDELINE

We will evaluate shareholder proposals on a *case-by-case* basis. We will generally *not support* proposals that place arbitrary or artificial constraints on the company, its board, or management.

### DISCUSSION

Shareholder proposals may take a number of forms but many are designed to somehow diminish the power of the board of directors or management by placing specific additional constraints on behaviour of the board, the management, or the company.

For example, some shareholder proposals may be designed to place constraints upon the composition of the board of directors. Other proposals may seek to place limits on the range of compensation within a firm by limiting the CEO's total compensation to a certain multiple of the average compensation within the firm.

While we empathize with the spirit of many of these proposals, most serve to introduce artificial or arbitrary constraints upon a company. We believe that a properly constituted and constructed board and management should address many of these issues in the normal course of fulfilling their responsibilities. We also believe that the board and management must maintain sufficient flexibility to organize the company in a fashion that is most appropriate for it at that time and that the company should be free to compete in its marketplace. Introducing artificial or arbitrary constraints will not assist, and may often hinder, the company's ability to create long-term value for its shareholders.

## 4.7 STAKEHOLDER PROPOSALS

### GUIDELINE

We will review stakeholder proposals on a case-by-case basis. We will *generally not support* proposals that seek to alter the responsibility of the directors to supervise the management of the business of the corporation or that create a wide range of peripheral considerations the directors must take into account in evaluating a business proposal.

### DISCUSSION

We clearly recognize that to effectively manage a corporation, directors and management must consider not only the interests of shareholders, but the interests of employees, customers, suppliers, creditors, and the community as well. However, corporate officers and directors must fulfill their fiduciary duty and recognize that their first priority is to the owners of their corporation, its shareholders.

Stakeholder proposals often demand that directors consider the effects of their decisions on numerous other corporate constituencies at the expense of the company's shareholders. They are often inconsistent with the director's fiduciary duty and may serve to undermine the long-term value of the company. In our view, directors should not be put in the position of having to give equal or more consideration to the interests of "stakeholders" than to the long-term interests of shareholders.



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