Canadian Foundation *for*
Advancement *of* Investor Rights

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Re: Request for Comments – 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 Foundation for the Advancement of Investor Rights ("FAIR Canada") in response to the above request for comments.

FAIR Canada is a non-profit, independent national organization founded in 2008 to represent the interests of Canadian investors in securities regulation. Additional information about FAIR Canada and its governance and priorities is available on our website at www.faircanada.ca.

GENERAL COMMENTS

As you are aware, FAIR Canada wrote to the TSX on January 21, 2009 to urge the TSX to act promptly to amend its listing rules to give shareholders the right to approve acquisitions that would result in the significant dilution of their shares, whether or not a private or public company is being acquired. FAIR Canada is encouraged that the TSX has realized that such an amendment is necessary to protect the integrity of shareholders' investments and to foster investor confidence in TSX listed issuers. We believe that the adoption of a shareholder approval requirement is consistent with the objectives of the TSX, specifically, "…to provide the guidance issuers need to meet the combined expectations of investors and all other market participants".

We do not agree, however, with the TSX's proposal to set the dilution limit at 50% prior to requiring shareholder approval. Our reasons are set out in this submission.

The TSX proposal fails to conform to the standards of major international markets

Virtually all major international markets require shareholder approval at a lower level of dilution. The NYSE, Amex, NASDAQ, London Stock Exchange (LSE), Hong Kong, Singapore and Johannesburg exchanges all require shareholder approval for transactions that result in dilution ranging from 20% to 30%, with the most prevalent (and the U.S. standard) being 20%.

Contrary to the information in Appendix C (Summary Overview of other Exchange Requirements) of the TSX Request for Comments, the Hong Kong Stock Exchange ("HKEx") does not allow dilution up to 50% without shareholder approval. It requires all share issuances (with certain exceptions such as the insurance of stock options) to be approved by shareholders.

FAIR CANADA is of the view that the listing rules of the TSX should be brought in line with those of other major international exchanges, particularly those of the U.S. given the number of issuers that are cross-listed in the U.S. and Canada. **Accordingly, the maximum dilution allowed prior to requiring shareholder approval should be 20%.**

The TSX proposal fails to conform to international best practices

Corporate governance standards set by major international organizations require shareholder approval for significant share issuances including for acquisitions. For example, the Organization for Economic Cooperation and Development ("OECD") has developed *Principles of Corporate Governance*, which Canada has endorsed. Those Principles include the following statement:

> *Shareholders should have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes such as: 1) amendments to the statutes, or articles of incorporation or similar governing documents of the company; 2) the authorization of additional shares; and 3) extraordinary transactions, including the transfer of all or substantially all assets, that in effect result in the sale of the company.* [1]

The International Corporate Governance Network ("ICGN") represents investors, companies, financial intermediaries, academics and other parties interested in the development of global corporate governance practices. The ICGN *Statement on Global Corporate Governance Principles* states as follows:

> *4.5 **Shareholder Participation in Governance:** Shareholders should have the right to participate in key corporate governance decisions, including the right to nominate, appoint and remove directors on an individual basis as well as the*

[1] Part I, s. II. B, OECD Principles of Corporate Governance, 2004, available at: www.oecd.org/daf/corporateaffairs/principles/text. See also Part II, s. II where the right of shareholders to approve extraordinary transactions is referred to as one of the most basic rights of shareholders.

> *external auditor and the right to approve major decisions of the nature referred to in Section 4.9*
>
> *4.9* ***Major Decisions****: Major changes to the core businesses of a corporation and other major corporate changes which may in substance or effect materially dilute the equity or erode the economic interests or share ownership rights of existing shareholders, including major acquisitions and major dispositions and closures of businesses, should not be made without prior shareholder approval of the proposed change.*

It is noteworthy that Peter Dey was the Chairman of the ICGN Global Corporate Governance Principles Committee drafting these principles and also on the OECD committee responsible for drafting the OECD *Principles of Corporate Governance*. Canada's perspective and interests were well represented when these corporate governance principles were formulated.

The Canadian market is not sufficiently unique to justify departing from international norms

The heavy weighting of small resource issuers in the TSX listings is not sufficient to justify the TSX's proposed departure from international norms. **We note that most markets consider themselves to be unique in some way, and assertions regarding the unique features of a marketplace are often used to bolster arguments against compliance with international best practices.** It would be a mistake for the TSX to conclude that the characteristics of TSX listed issuers justify lowering the corporate governance standards for those issuers. In adopting a 50% threshold, Canada would essentially be asserting that it was adopting second class governance standards. International investors could see TSX listed companies as being second class in terms of corporate governance.

Furthermore, FAIR Canada is of the view that TSX-V listed issuers should be subject to the same 20% dilution limit as issuers listed on the TSX. Good corporate governance and basic shareholder rights should always be respected, no matter what the size or market capitalization of an issuer.

The TSX is not in a position to impartially determine what corporate governance standard is in the public interest

FAIR Canada is of the view that there is an inherent conflict between (a) the "for profit" listed company status of the TSX where its responsibility is to maximize profits for its shareholders and (b) the TSX acting as a regulator of listed companies where the public interest should be paramount.

It is our position that the TSX/TSX-V listed company regulatory function should either:

(1) operate as a separate entity within the TMX with its own board of directors; or
(2) at the very least, the regulatory function should operate independently of the business side of the TSX with an appropriate Chinese Wall and other checks and balances.

The world's leading stock exchanges like NYSE, NASDAQ, HKEx and ASX separated the regulatory function from the business side when they went public. In the UK, the Financial Services

Authority (FSA) simply took listed company regulation away from the LSE and it is now a division of the FSA. We are not recommending the UK model for Canada.

We urge the TSX address the conflict of interest issue on a timely basis. Action to correct this serious deficiency in our regulatory framework will enhance shareholder confidence in the TSX and in our equity markets, a confidence that has been eroded in recent years.

BENCHMARKING

As noted above, the major markets require shareholder approval for major acquisitions. Contrary to the TSX Benchmarking summary, HKEx does require shareholder approval for dilution **even below the 20% threshold**. At an annual general meeting (AGM) shareholders of a HKEx listed company can prospectively approve a listed company issuing up to 20% of its existing issued shares, but that shareholder approval must be renewed annually. This is referred to as the "general mandate". Any transaction that results in dilution above the 20% general mandate must be specifically approved by shareholders. If shareholders have not approved a General Mandate, share issuances are subject to pre-emptive rights even below 20%. The 50% test referred to by the TSX applies in circumstances where an acquisition whether paid for in cash or shares (referred to as "Major Transaction") represents in excess of 50% of assets, profits, revenue or consideration. The 50% test for shareholder approval for a Major Transaction is in addition to the need for shareholder approval for share issuances in excess of 20% which itself requires shareholder approval.

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?***

Shareholder approval should 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?***

FAIR Canada does not believe that requiring a shareholder vote will have a meaningful negative impact on a reasonable acquisition. With the minimum takeover period now 35 days, the requirement to hold a shareholder meeting should not significantly impact the length of time it takes to complete an acquisition. Furthermore, a shareholder meeting is often required to be held by the target company so a shareholder meeting for the offeror company would not cause any delay.

While seeking shareholder approval would represent an extra step for an acquiring corporation, we note that dealing with angry shareholders who do not get a chance to vote may be far more distracting to the corporation and the marketplace. In the case of Goldcorp/Glamis, Goldcorp had to spend considerable effort fighting a campaign led by its largest shareholder and former

CEO. The objective of the campaign (which was supported by more than a thousand shareholders) was to force Goldcorp to obtain shareholder approval for the acquisition of Glamis. In the case of HudBay/Lundin, shareholders appealed the TSX decision not to require shareholder approval to the OSC. The OSC overturned the TSX decision in order to protect the rights of shareholders that were not given the right to vote on a proposed acquisition that would dilute their shares by in excess of 100%. These two cases detracted from investor conference in the integrity of the Canadian markets and in the TSX as a regulator. Only the decision of the OSC to overrule the TSX helped restore confidence in the markets but this did not restore confidence in the TSX as a regulator.

Shareholders are not interested in limiting the growth prospects of companies by making transactions difficult to complete. Shareholders care about whether the proposed business combination makes sense and how it will lead to an increase in shareholder value. Pragmatically, shareholders will only veto a transaction proposed by management where it is clear to the vast majority of shareholders that the transaction will result in the destruction of shareholder value. The requirement for a shareholder vote is a straightforward channel through which Canadian issuers can build sustained trust and commitment from capital providers. It will not curtail acquisitions that are acceptable to a majority of shareholders. Shareholder approval is a means to ensure fairness and accountability and to facilitate ongoing issuer and market success.

As for deal certainty, FAIR Canada is confident that once a dilution limit is established, parties will be able to plan their transactions accordingly and deal certainty will not be impacted in any material way.

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

We do not believe that the proposed Amendment will affect the competitiveness of TSX listed issuers. As noted above, the world's leading financial markets already require shareholder approval for diluted acquisitions of both public and private companies. In fact, FAIR Canada is concerned that the failure to bring the TSX listing requirements in line with those of other major exchanges would actually make TSX issuers less competitive. Without adequate protection for shareholders, investors would have less confidence in TSX listed issuers. Their reluctance to invest could lead to a "made in Canada" discount.

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?***

FAIR Canada does not think that the Amendment strikes the appropriate balance between shareholders and issuers because the proposed dilution limit of 50% is too high. **At that level, the TSX is going too far to facilitate the business interests of the managers of its listed issuers at the expense of good corporate governance and the protection of the fundamental rights of shareholders.**

In addition, the current dilution limit for acquisitions of private companies is 25%. FAIR Canada does not believe that there is a principled reason to allow greater dilution without shareholder approval when a public company is acquired. The TSX maintains that the distinction is

appropriate because there is more information available about a public company that would allow shareholders to assess the merits of a proposed acquisition. FAIR Canada rejects this rationale, since the ability of shareholders to assess the merits of a proposed acquisition is meaningless if they are not given the right to approve it. Further, as the TSX notes in its Request for Comments:

> *All commentators agreed that factors other than dilution should not be considered by TSX in determining whether security holders approval should be required. Commentators [universally] agreed that dilution was the only appropriate factor to consider when setting a brightline test for security holder approval. (TSX Request for Comment)*

FAIR Canada is of the view that the maximum dilution limit should be 20%, irrespective of whether a public or private company is being acquired.

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 to 20%) will be to bring the TSX requirements in line with that of other major exchanges and internationally accepted best practices. By doing so, the TSX will foster investor confidence in TSX listed issuers, encourage investment in them and lower the cost of capital for all TSX listed companies.

Any additional transaction costs associated with the need for shareholder approval would not be material in the context of an acquisition and justified by the need to ensure the protection of shareholders' rights.

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?

FAIR Canada 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 particular concern. 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, a board of directors could fundamentally change a Canadian corporation through an acquisition without having to obtain shareholder approval. This is contrary to global best practices and, in FAIR's view, unacceptable.

A 50% threshold would be more likely (than a 20% threshold) to lead to avoidance tactics such as using 49% shares and the balance in cash.

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?

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As noted above, FAIR Canada is of the view that 20% is the appropriate level of dilution above which shareholder approval should be required.

While less than ideal, we would not object to 25% threshold which is currently used by the TSX in requiring shareholder approval for dilution in acquisitions of private companies. In any event, the thresholds for private and public company acquisitions should be harmonized.

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.***

Please see our response to Question #5, above. Although FAIR Canada acknowledges that issuers might incur some additional costs to obtain shareholder approval at lower dilution levels, those costs are entirely justified in the interest of protecting the rights of shareholders. The requirement for shareholder approval will impose a discipline on management and strengthen the company's bargaining position since the target will know that the price would need to be acceptable to shareholders of the buyer. Shareholders are the owners of the company and are the key stakeholders.

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?***

FAIR Canada believes that if dilution is allowed as high as 50%, there will be many occasions when the quality of the marketplace will be adversely affected by a proposed transaction within the meaning of s. 603, such that the TSX would be called upon to intervene to require an issuer to obtain shareholder approval. It is noteworthy that in the recent HudBay case, the OSC found that, "[f]air treatment of shareholders is a key consideration going to the integrity and quality of the capital markets". With dilution approaching 50%, it would be difficult to maintain that shareholders who are not allowed to vote on a proposed transaction are being treated fairly.

A more reasonable dilution limit of 20%, would provide a clear threshold that would limit the need for the TSX to exercise its discretion under s. 603. That being said, 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, even when 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. The U.S. exchanges do not have the discretion to grant an exemption from the requirement for shareholder approval if dilution is in excess of 20%.**

We note 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 in response to it. This makes it particularly important for the TSX not to exercise its discretion to allow dilution over the established limit, essentially on an ex-parte basis.

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

FAIR Canada has no objection to the exemption in section 604(d) of the Manual applying 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 shares with disproportionate voting rights.

We note that the HKEx permits written shareholder approval by more than 50% where the approvals obtained from a controlling shareholder or a "closely allied group of shareholders" who together hold more than 50% of the shares. HKEx is a relevant comparison because like the TSX there are a significant number of listed companies that are controlled. The HKEx cautions listed companies on the problems of disclosing unpublished price sensitive information to shareholders in confidence in order to solicit their approval.

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?

FAIR Canada does not think that boards should have the right to seek shareholder approve for dilutive transactions in advance on an annual basis.

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.

As noted above, the HKEx permits shareholder approval for the issuance of shares up to 20% under the General Mandate. Not all HKEx listed companies seek approval for a 20% mandate. In fact, the HKEx itself only seeks approval for the issuance of up to 10% under its General Mandate.

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. FAIR agrees that the costs of such an approach outweigh the benefits.

We would be pleased to discuss our comments with you in more detail at any time.

Sincerely,

Ermanno Pascutto,
Executive Director