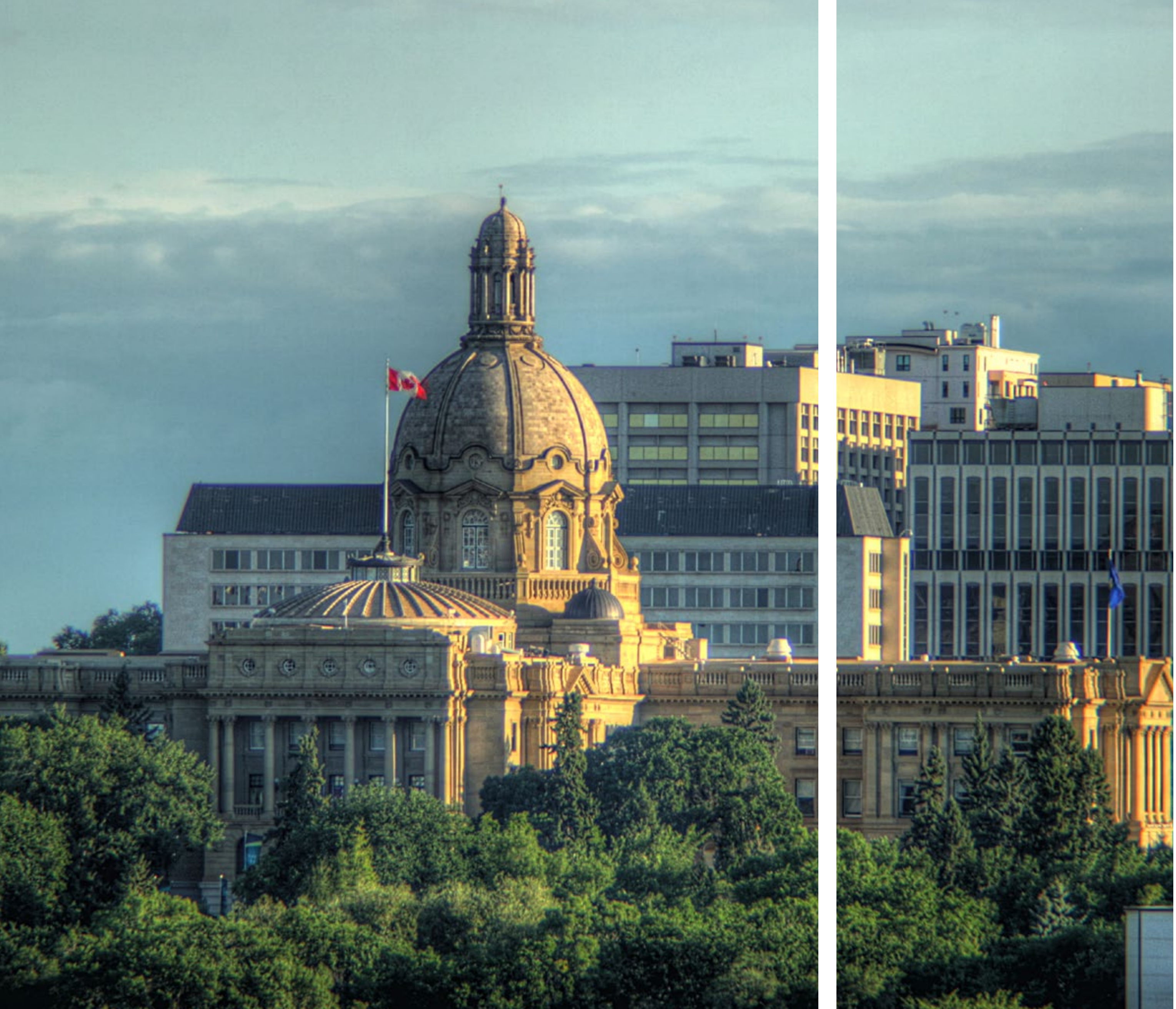

OFF THE BALLOT

Why Alberta's business laws need to catch up on shareholder democracy

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Author: Kevin Thomas
Research: Brittany Stares
Editing and Review: Peter Chapman, Jackie Cook, Shannon Rohan

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Introduction

Canadian companies that are incorporated in Alberta have at least one distinct difference from their counterparts incorporated elsewhere in the country: their shareholders are effectively unable to file shareholder proposals to be voted on at the company's annual meeting.

Shareholder proposals are a part of the process of dialogue between a company and its investors. They allow investors to raise concerns regarding corporate governance, company policies and gaps in practice that have impacts on shareholder value. While shareholder proposals are submitted for inclusion on the ballot for the company's annual meeting, in many cases they are withdrawn prior to the vote after constructive dialogue between the shareholder and management resolves the issue in question.

Shareholder proposals have been used by investors across North America to press for greater board diversity, for better disclosure of material risks, for improvements in shareholder democracy, and for improvements in environmental or social performance.

But not in Alberta. The *Alberta Business Corporations Act* (ABCA) and its associated Regulations say that in order to file a shareholder proposal an investor must have a prescribed level of support from holders of 5% or more of voting shares.

This threshold is far more onerous than that which applies under the business corporation regulations of any other Canadian province as well as the federal *Canadian Business Corporations Act* (CBCA), where a shareholder needs only to hold shares worth $2,000 in order to file a proposal. The ABCA requirement effectively prevents the overwhelming majority of shareholders of Alberta corporations from filing a proposal. In only eight of the 45 Alberta-incorporated companies on the TSX Composite Index does a single institutional shareholder hold more than 5% of the common voting shares. Only four of those companies have more than one institutional shareholder with a sufficient position to file a proposal.

While shareholders in Canada and the US have filed proposals this year, as in previous years, asking for greater gender diversity on boards of directors, improved oversight of executive compensation, due diligence on human rights in global supply chains, and disclosure of climate change risks, companies incorporated in Alberta have received zero proposals from shareholders.[1]

SHARE's research analyzed whether this legal impediment to shareholder democracy and dialogue has had any effect on the governance of Alberta-incorporated firms.

We looked at gender diversity amongst the board and senior management, certain basic corporate governance measures, and disclosures of information related to climate change and carbon emissions. In each area, we found Alberta-incorporated companies, on average, to be lagging their peers in the TSX Composite Index.

This doesn't have to be the case. In Canada a strong tradition of investor relations has developed and this has helped companies be responsive to shareholder concerns and achieve significant improvements in corporate governance. Shareholder resolutions have been an important part of that process.

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Our study

We identified 45 companies on the TSX Composite Index[2] that are incorporated in Alberta. The other 205 companies are currently incorporated under the Canada Business Corporations Act or under other provincial Acts (or, in one case, the Cayman Islands). We examined every company on the TSX Composite Index, including those incorporated in Alberta, to determine the company's performance on:

- Board and executive gender diversity, using 2016 data from the Canadian Securities Administrators on board and executive gender diversity policies and outcomes, released on March 8, 2017;[3]
- Corporate governance, using 2016 company scores assigned in the Globe and Mail's annual "Board Games" survey on corporate governance,[4] released in November 2016, as well as three specific measures of good corporate governance; and
- Scores on CDP (formerly Carbon Disclosure Project) disclosures, using 2016 grades assigned by the CDP for reports submitted to the CDP by participating companies, released in December 2016.

For each category we separated the Alberta-incorporated firms (45 in total) and the rest of the TSX Composite Index firms (205 in total) and calculated average results. Noting that all but eight of the Alberta-incorporate firms in the TSX Composite Index are categorized as Energy Sector firms, we also ran the same tests using only the Energy Sector firms both in Alberta (37 firms) and the rest of the TSX Composite Index (13 firms) to see whether the differences should be attributed to sector bias.

Overall, our research found that TSX Composite Index companies that are incorporated under the *Alberta Business Corporations Act* underperform in all three areas of study.

Results: Gender diversity

- 35.5% of Alberta-incorporated companies on the TSX Composite Index had zero women on their board of directors in 2016, compared to 10.8% of the TSX Composite Index companies incorporated in other jurisdictions.
- The average percentage of women on boards of directors of Alberta-incorporated companies on the TSX Composite Index was 10.5% in 2016, compared to 17.8% for the TSX Composite Index companies incorporated in other jurisdictions.
- Results were almost identical[5] when reviewing only Energy sector companies, demonstrating that the diversity results were not merely a reflection of the prevalence of Energy sector companies in the Alberta-incorporation list.
- The average percentage of women in executive positions of ABCA-incorporated companies on the TSX Composite Index was 13.5% in 2016, compared to 16.8% for the TSX Composite Index companies incorporated in other jurisdictions. When reviewing only Energy sector companies on the Index, Alberta-incorporated Energy companies on the Index performed even more poorly compared to their non-Alberta-incorporated counterparts.[6]
- Only nine of the 45 Alberta-incorporated companies on the TSX Composite Index disclosed written gender diversity policies in 2016 (20%). Sixty-two of the other constituents of the Index disclosed a written gender diversity policy in 2016 (30.2%). As above, amongst Energy sector companies, the gap is still wider.[7]

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Results: Corporate governance

Alberta-incorporated firms scored slightly poorer on the annual "Board Games" survey than TSX Composite Index companies that are incorporated elsewhere, though the gap in performance was not as significant as that on gender diversity. The average score for Alberta-incorporated firms was 70.6 out of 100, compared to 73.8 for non-Alberta firms on the TSX Composite Index. When Energy sector companies alone were compared, the gap in scores widened to more than 6 points (69.6 for Alberta-incorporated Energy firms vs 76 for other Canadian Energy firms).

Some of the corporate governance improvements that have been advanced through shareholder proposals in other jurisdictions include:

- **Adoption of advisory votes on executive compensation ("Say on Pay"):** The initial momentum for the adoption of "Say on Pay" votes in Canada came from shareholder proposals filed by Meritas Mutual Funds (working with SHARE) at Canadian banks in 2008. To date there have been more than 65 shareholder proposals filed at Canadian companies urging adoption of annual "Say on Pay" votes. However as of 2016, 20 out of the 45 Alberta-incorporated companies on the TSX Composite Index still did not hold an annual "Say on Pay" vote. That represents 44.4% of Alberta-incorporated companies, which is above the rate for the rest of the TSX Composite Index (at 42.9%).
- **Splitting the Board Chair and CEO roles:** Best practices in corporate governance suggest that the role of CEO and that of Board Chair should be held by different people, and that the Chair should be an independent Director. In 2016, 48 shareholder proposals were filed at US companies asking that the Chair be independent.[8] At eight of the 45 Alberta-incorporated companies on the TSX Composite Index, the role of CEO and Board Chair was not separate in 2016, a 17.8% rate of non-compliance compared to 10.3% for the rest of the Index.
- **Clawback provisions:** A policy on "clawback" of executive compensation allows the board to force withdrawal or repayment of some executive compensation if there is evidence of wrongdoing, such as financial impropriety. Seven shareholder proposals were filed last year in the US asking for adoption of clawback provisions. Two proposals were filed in Canada in 2015 (each receiving more than 97% of the shareholder vote) and, so far, one proposal has been filed in Canada in 2017 (at Valeant Pharmaceuticals) and was withdrawn upon reaching agreement with the company. 35.6% of the Alberta-incorporated companies on the TSX Composite Index had no clawback provisions in 2016, compared to 28.8% of the remaining firms on the Index.

Alberta-incorporated firms scored slightly poorer on the annual "Board Games" survey than TSX Composite Index companies that are incorporated elsewhere.

Results: Climate change

Each year more than 6,000 companies worldwide, including 200 companies in Canada, are asked to complete a survey disclosing their CO2 emissions and the company's oversight and management of climate-change-related risks and opportunities. The CDP (formerly Carbon Disclosure Project) questionnaire is graded annually and the scores made available publicly to demonstrate which companies are leading on addressing the issue of climate change in their businesses. The CDP project is supported by 827 institutional investors with more than $100 trillion in assets under management. A large number of shareholder proposals have been filed elsewhere in Canada and the US asking companies to provide this annual disclosure to better allow investors to assess climate-change-related risks with the companies they own. However in Alberta, where shareholders have been unable to file resolutions:

- Nineteen of the thirty (63.3%) Alberta Energy companies on the TSX Composite Index that were asked to report to the CDP in 2016 were graded "F" by the CDP. An "F" grade signifies that a company was requested to disclose data to the CDP and failed to do so, or failed to provide sufficient information.[9]
- Only two of the thirteen other Energy companies listed on the TSX Composite Index (but incorporated outside of Alberta) were graded "F" by the CDP in 2016 (15.4%).[10]

Conclusion and Recommendations

Although some Alberta-incorporated companies constructively engage their shareholders and are significantly improving corporate governance, environmental and social policies and performance, among large publicly-traded companies, ABCA-incorporated companies on average underperform their TSX Composite Index peers.

While there are undoubtedly many reasons for each company's individual performance, we believe that an improvement in shareholder democracy is one of the tools that can help remedy the situation.

At present shareholders are restricted from filing proposals for a vote at the annual meeting of Alberta-incorporated companies by regulations that are inconsistent with the norm in the rest of North America. These restrictions mean that most investors are unable to advance better corporate governance principles through the use of a shareholder vote. Investors in other jurisdictions in Canada and the US, by contrast, have made ample use of the vote to improve board diversity, corporate governance, and company responses to the urgent problem of climate change.

Further, without the ability to file proposals to encourage better governance or changes to environmental or social policies and practices, investors in Alberta-registered companies are more likely to choose the option of selling their shares if they have concerns, which could disadvantage Alberta-incorporated companies vis-à-vis their peers in other Canadian jurisdictions.

Recommendations:

- SHARE recommends that the *Alberta Business Corporations Act* (ABCA) regulations be amended to establish a shareholder proposal filing threshold that is substantively the same as that set out in the federal *Canada Business Corporations Act* (CBCA) and associated Regulations, which require a filer to hold

  i) voting shares equal to 1% of all such shares, or

  ii) voting shares with a market value of $2,000

  without the current additional requirement in the ABCA of support from shareholders owning 5% of issued voting shares.

Motivated owners:
Additional opportunities to promote diversity, governance goals

The Ontario government amended its Pensions Benefits Act regulations in 2014 to require pension plans registered in the province to report annually on whether, and if so how, they incorporate environmental, social and governance (ESG) concerns in their investment decision-making process. This simple requirement has empowered pension trustees to consider the relevance of ESG factors to the success of their investments, and to use their influence as investors to encourage better ESG performance with the companies they own. Pension plans that have adopted a strong "active ownership" program are at the forefront of engagement with corporate boards on issues like better governance, board diversity, and addressing climate risks.

Alberta could amend the regulations under the *Alberta Employment Pension Plans Act* (EPPA) to require registered pension plan administrators to disclose whether, and if so how, the consideration of environmental, social and governance (ESG) factors is reflected in the plan's investment policy and practice. This simple amendment would clarify that it is legitimate for Alberta pension trustees to consider ESG factors, unlocking investment activity that supports better governance practices by Alberta companies.

Notes

[1] A searchable database of Canadian shareholder proposals can be found on our website at www.share.ca. Information on shareholder proposals in the USA can be found at http://fundvotes.com/resolutionsbycategory_countavg.php.

[2] Constituents of the TSX Composite Index as of January 12, 2017.

[3] Data is available at: http://www.osc.gov.on.ca/en/52327.htm

[4] Each year the Globe and Mail collaborates with the Clarkson Centre for Business Ethics and Board Effectiveness at University of Toronto to examine the boards of directors of 231 companies and trusts in the S&P/TSX composite index to assess the quality of their governance practices. 2016 methodology available at: http://www.theglobeandmail.com/report-on-business/careers/management/board-games-2016/board-games-2016-how-we-did-the-marking/article33058992 .

[5] The average percentage of women on boards of directors of ABCA-incorporated Energy companies on the TSX Composite Index was 10.4% in 2016, compared to 16.9% for the TSX Composite Index Energy companies incorporated in other jurisdictions.

[6] The average percentage of women in executive positions of ABCA-incorporated Energy companies on the TSX Composite Index was 12.2% in 2016, compared to 17.8% for the TSX Composite Index Energy companies incorporated in other jurisdictions.

[7] 21.6% of ABCA-incorporated Energy companies on the TSX Composite Index disclosed written gender diversity policies in 2016, compared to 44.4% of Energy sector companies on the Index incorporated in other jurisdictions.

[8] http://fundvotes.com/resolutionsbysubcategory_countavg.php

[9] The CDP indicates that an "F" grade does not necessarily indicate a failure in environmental stewardship, but it does indicate a failure to disclose requested information to investors.

[10] There was, however, one very positive Alberta example. Only three companies on the TSX Composite Index were graded "A" by the CDP for their 2016 reports, and one of those (Vermilion Energy) is ABCA-incorporated. The other two were Great-West Lifeco Inc. and Canadian National Railway Company.

SHAREHOLDER ASSOCIATION
for RESEARCH & EDUCATION

Box 11171, Royal Centre, 26th Floor,
1055 West Georgia Street
Vancouver, BC V6E 3R5

T: 604 408 2456
F: 604 408 2525
E: info@share.ca

www.share.ca