

Dissident Proxy Circulars

Challenging the Status Quo

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Goodmans^{LLP}



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Introduction

In 2008 and 2009, amid a credit crisis and global economic downturn, dissatisfied shareholders proved proxy contests to be a viable method for effecting change.

In Canada, activist shareholders have a wide range of options for challenging the status quo. Various corporate statutes and applicable securities laws enable shareholders to do so through shareholder proposals, requisitioned shareholder meetings and proxy contests.

Of options available, shareholders have tended to rely on proxy contests as an effective means to replace directors, challenge the implementation of shareholder rights plans and to speak out against fundamental transactions approved by management and/or the board of directors. A proxy contest occurs when a dissident solicits shareholders' proxies and the right to vote those shareholders' shares in favour of the dissident group's objective.

For the purpose of this study, we have reviewed proxy contests that took place in Canada in 2008 and 2009 where dissident shareholders chose to use a dissident proxy circular to express their dissatisfaction in an effort to challenge the status quo.

This study should not be considered as providing legal advice in respect of any particular transaction. The matters associated with the dissident proxy circular process are often complicated and fact specific and it is strongly suggested that you contact any member of Goodmans' corporate securities team should you wish to discuss any transaction specific questions.

Methodology

We reviewed the 44 proxy contests launched in 2008 and 2009 against Canadian public company targets that involved the issuance of a dissident proxy circular. 22 of those contests took place in 2008 and the other half occurred in 2009. **See Appendix 1.** Proxy contests that did not feature the issuance of a dissident proxy circular are outside of the scope of this report.

Our study is based on a review of publicly available information for the surveyed proxy contests. Although we aim to provide a broad discussion of proxy contests in which the dissident issued a dissident proxy circular, our observations are not intended to be an exhaustive analysis of those events. While some of the proxy contests that we reviewed addressed issues such as the adoption of shareholder rights plans or other management proposals, the majority of these proxy contests placed particular emphasis on the replacement of directors. Accordingly, our discussion also focuses on the dissidents' efforts to replace directors of the target company.

In the course of our analysis we report on three possible outcomes of the proxy contests surveyed: (1) a dissident win; (2) a management win and (3) a partial win. A 'dissident win' refers to a scenario where the dissident accomplishes its objective in its entirety. In most instances this means that the dissident was successful in its goal to replace some or all of the board of directors with dissident nominees. A 'management win' involves an outcome in which the incumbent directors were re-elected or other management proposals were passed by shareholders. This outcome is, in effect, maintenance of the status quo. A 'partial win' means that the dissident has not fully accomplished its publicly stated goal but has managed to effect some change. In some cases this means that not all of the dissident's nominees were elected to the new slate of directors, but neither is it a management slate; the status quo is upset but not overthrown. Included in the definition of a 'partial win' are negotiated settlements between the dissident and the company where a compromise was reached with respect to the contest's issues. This compromise means that neither party accomplished its stated goals, but, a middle ground was found and the status quo was changed.

Key Observations

Based on our analysis, we make the following key observations:

- (1) Dissidents who issue a proxy circular are hugely influential. Once a dissident has decided to launch a proxy contest involving the issuance of a dissident proxy circular, the dissident stands a good chance to change the status quo. Overall in 2008 and 2009, dissidents were more successful than the target's board in the outcome of contests involving dissident proxy circulars.
- (2) As one might expect, dissidents with greater ownership in the target are more likely to succeed.
- (3) Venture Exchange issuers are more often subject to proxy contests than are TSX issuers.
- (4) The mining sector has tended to face a greater number of proxy contests than other sectors. In proxy contests launched against targets in the mining sector, dissidents were often successful.

1. Analysis: By Outcome

KEY OBSERVATION: *Dissidents who issue a proxy circular are hugely influential. Once a dissident has decided to launch a proxy contest involving the issuance of a dissident proxy circular, the dissident stands a good chance to change the status quo. Overall in 2008 and 2009, dissidents were more successful than the target's board in the outcome of contests involving dissident proxy circulars.*

In both 2008 and 2009, dissidents were more successful in proxy contests than management. See Chart 1.

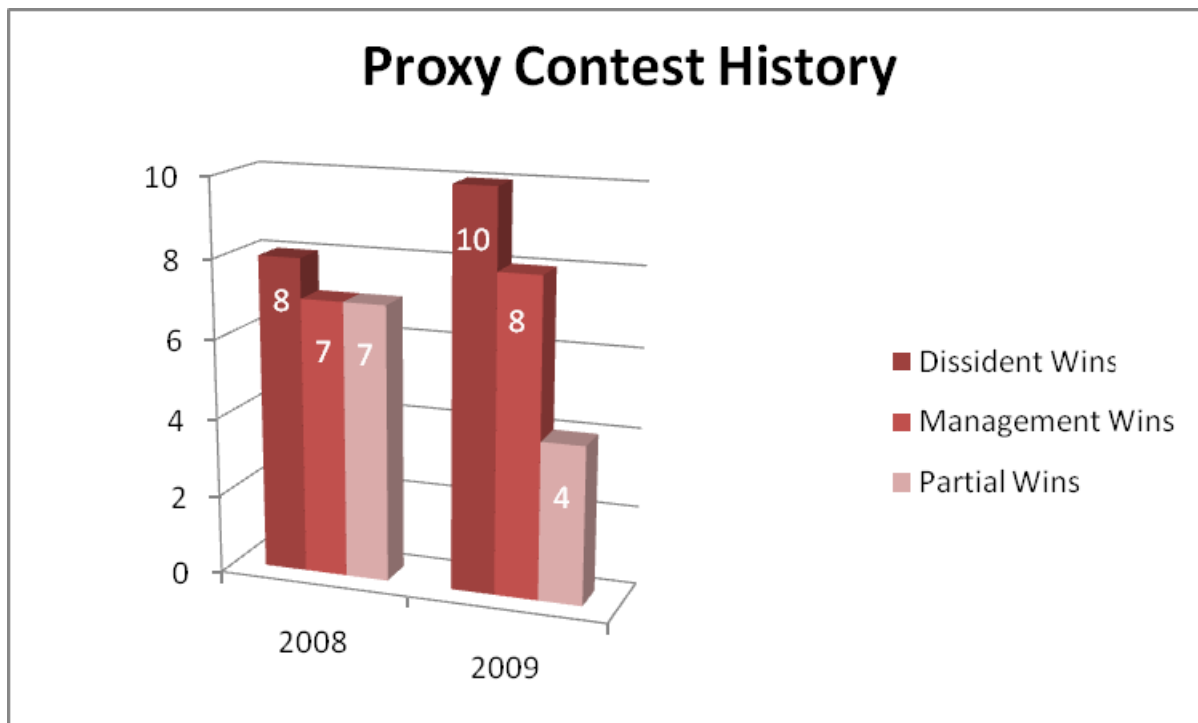


Chart 1: Outcome of Proxy Contests

Of 22 contests staged in 2008, eight were dissident wins. This meant that the dissident rate of success was 36%, whereas management was successful only 32% of the time. Similarly, in 2009 where dissidents won ten of 22 contests, the dissident's rate of success was 45%; management's rate of success was only 36%.

Significantly, contests resulted in partial wins 32% of the time in 2008 and 18% of the time in 2009, arguably making the proxy contest an effective tool for a dissatisfied shareholder since the dissident was able to alter the status quo in some fashion 66% of the time.

Given the cost and effort associated with issuing a dissident proxy circular, it appears that dissatisfied shareholders will only choose to take this dramatic step when they are confident in their prospects for at least a partial win. In other words, a dissident who is prepared to spend the time and money necessary to stage a full-fledged proxy contest involving a dissident proxy circular will likely have calculated the risks and taken stock of its supporters before initiating the process.

One thing is quite clear: in contests where a dissident proxy circular was issued, the dissident had a significant chance of success. As a result, a board of directors that receives notice of a dissident proxy circular should recognize it as a legitimate threat to the status quo.

2. Analysis: By Dissident

KEY OBSERVATION: *As one might expect, dissidents with greater ownership in the target are more likely to succeed.*

A dissident's success in staging a proxy contest is directly related to its share ownership. See Chart 2.

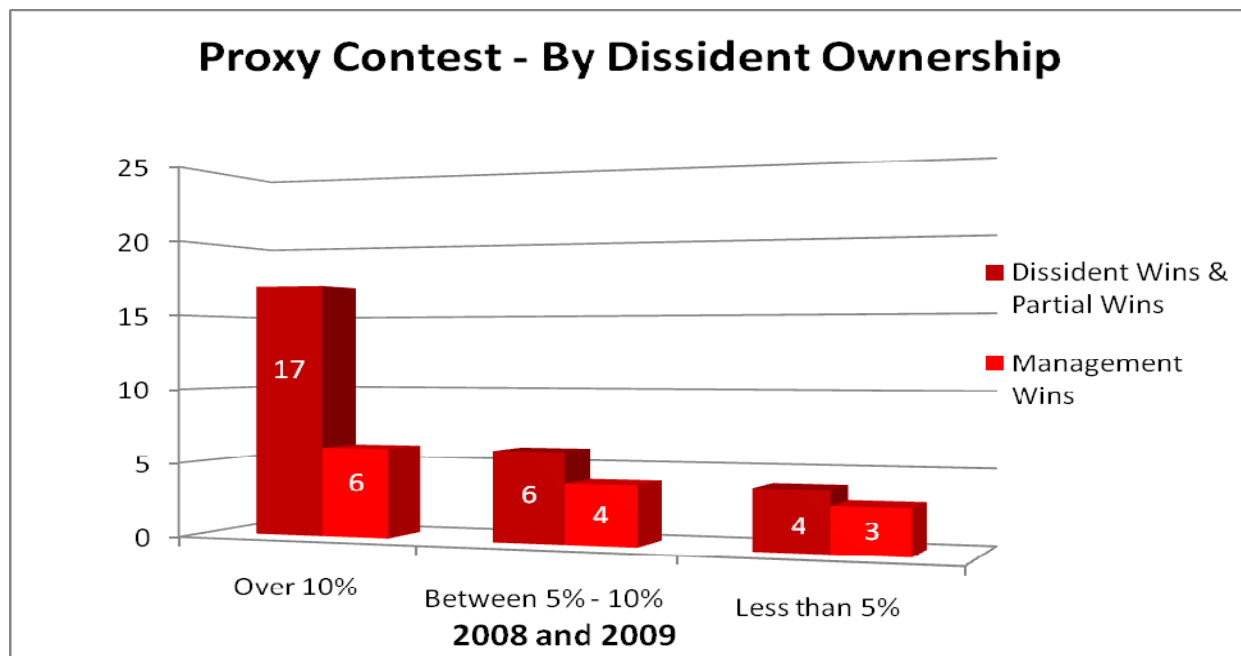


Chart 2: Dissident ownership relative to success

Chart 2 illustrates a correlation between the percentage of the target company controlled by the dissident, the number of proxy contests staged and the ability of shareholders to change the status quo. As the dissident's ownership in the target company dropped, so did the number of proxy contests and the ability of a dissident to impact change.

23 of the 44 proxy contests that took place in 2008 and 2009 occurred in circumstances where the dissident owned more than 10% of the target company. Furthermore, these contests were successful in changing the status quo 74% of the time.

As the percentage of the target held by the dissident dropped to between 5% and 10%, so did the number of proxy contests and the ability of the dissident to change to the status quo. When dissident ownership of the target was between 5% and 10%, there were only ten proxy contests launched during this period of which 60% resulted in either a dissident win or a partial win.

Finally, when dissident ownership of the target dropped to 5% and below, the number of proxy contests dropped to only seven, with a change to the status quo occurring 57% of the time.

Chart 3 provides further analysis of dissident ownership and shows that, in 2008, 62% of all proxy contests were launched by dissidents owning 10% or more of the target company. Of those contests, 38% resulted in dissident wins. Dissidents holding over 10% of the target staged 53% of the contests fought in 2009 and were successful 60% of the time. As noted above, not only were dissidents with greater ownership more likely to initiate proxy contests, but also they were more likely than management to be successful.

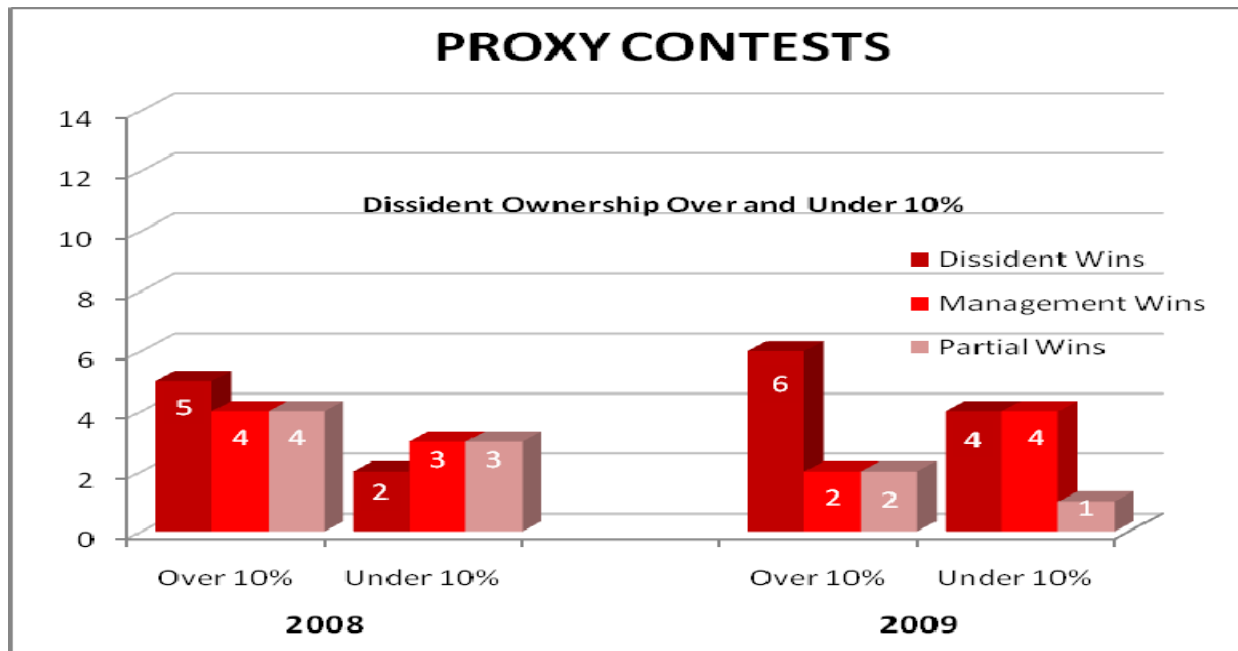


Chart 3: Dissident ownership relative to success

When the dissident’s ownership in the target was under 10%, outcomes were more commonly in management’s favour. With under 10% ownership, dissidents lost 38% of contests to management in 2008, whereas dissidents with over 10% ownership in the target lost only 31% of contests in the same year. In 2009, dissidents with under 10% ownership lost 44% of contests to management as compared to 20% lost to management when dissident ownership was over 10%.

This means that throughout 2008 and 2009, management won only 26% of the contests staged by dissidents owning over 10% of the target. However, when faced with a dissident possessing less than 10%, management was able to defeat that dissident 41% of the time.

The results of our survey indicate that when the dissident owned less than 10% of the target, management and the dissident had a rate of success in contests that was approximately equal. In 2008, both management and the dissident saw outcomes in their favour 38% of the time. In 2009, dissident success was 47% as compared to management’s 44% rate of success. Over these two years combined, proxy contests launched by dissidents owning less than 10% of the target were won by the dissident 42% of the time and won by management 41% of the time.

Although management’s chances of success in a proxy contest increased as the dissident’s ownership decreased, when taking into account partial wins, the dissident with over 10% ownership remained able to effect change in some respect 74% of the time and 59% of the time with under 10% ownership. In fact, in 2008, 69% of contests were won or partially won by dissidents owning over 10% and 63% of contests were won or partially won by those dissidents owning under 10% of the target. In 2009 dissidents saw similar success: dissidents owning 10% or more of the target won or partially won proxy contests launched by them 80% of the time. With less than 10%, the dissident won or partially won 55% of contests.

Based on our analysis, boards of companies with significant shareholders would be well advised to track and cultivate relationships with these shareholders in a manner that would mitigate the risks and costs associated with facing a proxy contest. Conversely, shareholders should be aware that as their ownership in a company increases, so does their ability to effectively challenge management.

3. Analysis: By Exchange

KEY OBSERVATION: *Venture Exchange issuers are more often subject to proxy contests than are TSX issuers.*

In both 2008 and 2009, issuers listed on the TSX Venture Exchange (the “**Venture Exchange**”) faced a greater number of proxy contests than did issuers listed on the Toronto Stock Exchange (the “**TSX**”). See **Chart 4**.

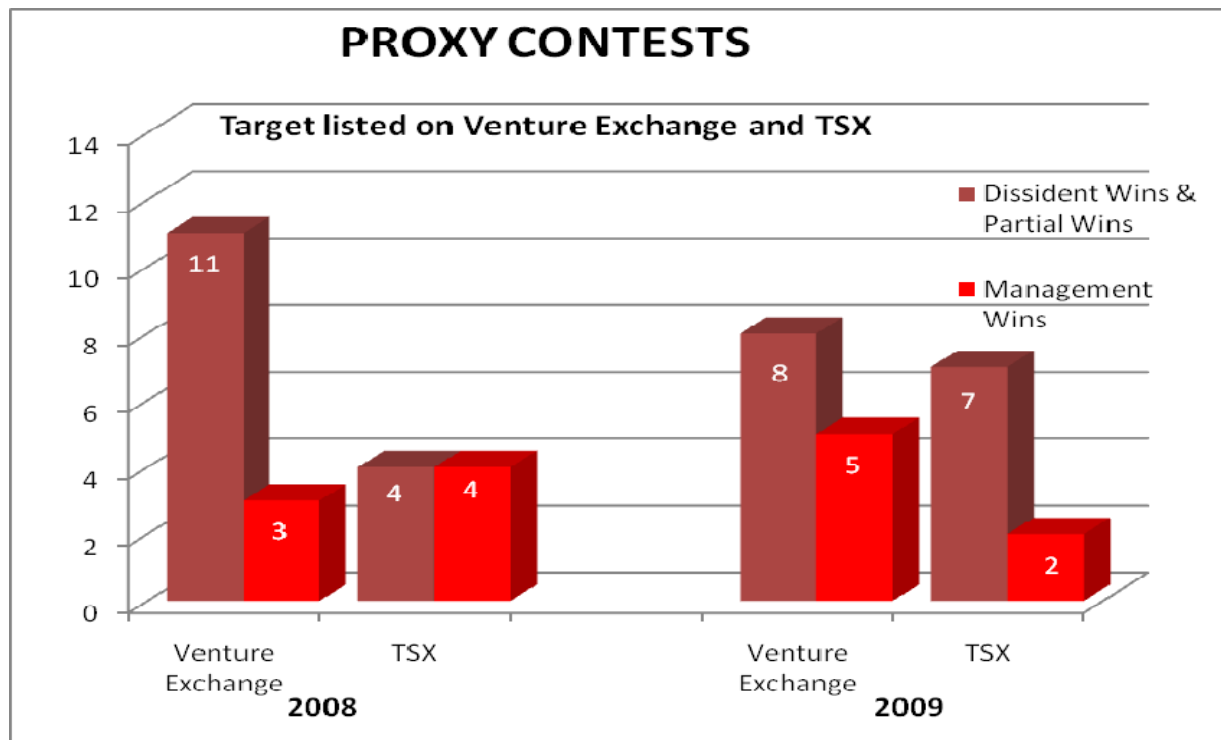


Chart 4: Proxy contests on Venture Exchange versus contests staged on TSX.

Issuers listed on the Venture Exchange experienced 14 of 22 total contests in 2008. Dissidents in that year were able to influence change to the status quo of those Venture Exchange issuers 79% of the time winning or partially winning contests eleven of 14 times.

Only eight of 22 contests launched in 2008 were initiated against TSX-listed companies. Of those contests, dissidents and management each saw favourable outcomes in four contests.

In 2009, 13 of 22 proxy contests were initiated against targets listed on the Venture Exchange. Eight of those contests were won or partially won by dissidents, while the remaining five were won by management. In the same year, dissidents won or partially won seven of nine contests staged against TSX listed companies, leaving management with only two wins.

Consistently, Venture Exchange issuers were more vulnerable to attack by concerned shareholders. Because Venture Exchange issuers are smaller than those companies listed on the TSX, gaining a significant ownership interest is typically easier, making a proxy contest a viable option for a dissatisfied shareholder. Additionally, where smaller companies are concerned, ownership is typically more concentrated, lessening the burden on the dissident to rally support.

The greater number of proxy contests faced by Venture Exchange issuers in 2008 and 2009 may be further explained by the higher proportion of mining companies listed on that exchange, as compared to mining sector issuers listed on the TSX. As will be explored in the following section, the mining sector experienced a significantly greater number of proxy contests than all other sectors in 2008 and 2009.

Another factor contributing to the vulnerability of Venture Exchange issuers to proxy contests may be their tendency to operate under a less restrictive corporate governance regime. Issuers on the TSX are bound by governance rules not similarly imposed on Venture Exchange issuers. For example, Multilateral Instrument 52-110, *Audit Committees* requires reporting issuers to maintain, among other things, an audit committee comprised of independent directors. However, Venture Exchange issuers are exempted from certain requirements of this instrument, including those relating to the independence of directors. Such discrepancies in governance rules for TSX issuers and Venture Exchange issuers may mean that dissidents have less reason and motivation to initiate proxy contests against more highly regulated TSX targets and may have more reason to initiate proxy contests against Venture Exchange targets.

Directors and shareholders should be aware that proxy contests have tended to be launched against Venture Exchange issuers more frequently than against their counterparts on the TSX. As a result, Venture Exchange issuers may consider mitigating the risk of facing a proxy contest by implementing, among other things, more stringent governance policies.

4. Analysis: By Sector

KEY OBSERVATION: *The mining sector has tended to face a greater number of proxy contests than other sectors. In proxy contests launched against targets in the mining sector, dissidents were often successful.*

Companies in the mining sector saw, by far, the greatest number of proxy contests in 2008 and 2009. See Chart 5 and Chart 6.

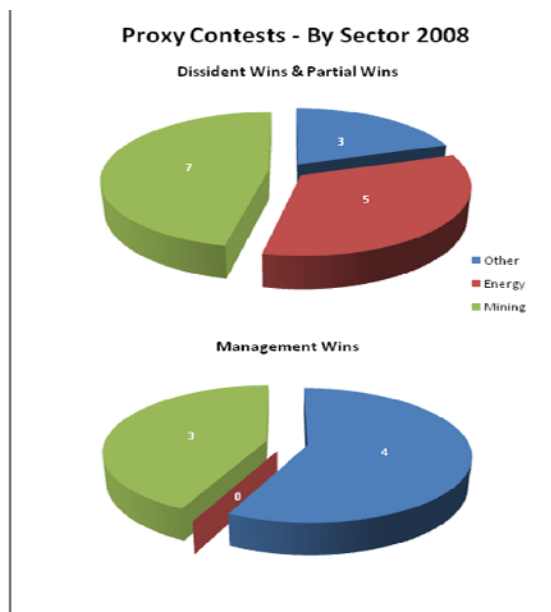


Chart 5: 2008 Proxy contests - by Sector.

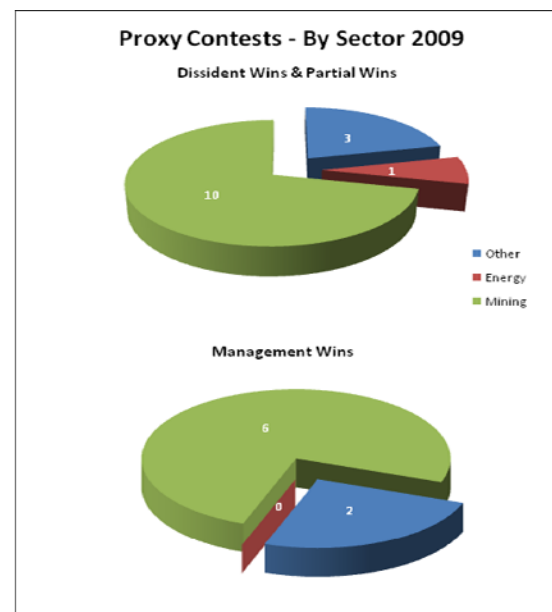


Chart 6: 2009 Proxy contests - by Sector.

In 2008, targets in the mining sector experienced ten of 22 contests and dissidents were successful or partially successful 70% of the time. In 2009, 16 of 22 contests were initiated against targets in the mining sector. Of those, dissidents effected change 63% of the time.

The high number of proxy contests initiated against targets in this sector can, at least in part, be explained by the proportionately higher number of Canadian public issuers in the mining sector. In addition to the greater number of mining sector issuers, the mining sector, when compared to all other sectors combined, is more likely to be subject to proxy contests. Between the TSX and the Venture Exchange, the mining sector comprises 39% of all issuers. The total number of proxy contests in the mining sector makes up 59% of the number of contest for the years 2008 and 2009¹, suggesting that proxy contests are more likely to take place in the mining sector.

This high number of proxy contests launched during this period may also be attributed to the fact that base metal prices fell significantly in 2008, leading to shareholder dissatisfaction and providing dissidents with ammunition in both 2008 and 2009 to launch proxy contests.

Other sectors including financial services, pharmaceuticals and goods and services also faced proxy contests in 2008 and 2009. Each of these sectors experienced only one or two contests in 2008 and 2009.

The energy sector saw five contests in 2008 but only one in 2009, all of which were resolved in the dissident's favour. It is likely that the significant drop in the price of oil in the latter half of 2008 had a direct impact on shareholder satisfaction and therefore on shareholder activism.

¹ There are currently 1,092 issuers in the mining sector listed on the Venture Exchange and only 327 such issuers listed on the TSX.

Appendix A

Summary of Canadian Proxy Contests - 2008

Target	Dissident Shareholder(s)	Date of Proposal	Result/Commentary
Biovail Corporation	Eugene Melnyk and EM Holdings B.V.	May 16, 2008	Management Win
Coronation Minerals Inc.	Guyana Goldfields Inc.	February 7, 2008	Dissident Win
Echo Energy Canada Inc.	Challenge Gas Holding AB, Exclusive Asset Management Inc. and Salvatore Fuda	April 4, 2008	Dissident Win
First Calgary Petroleum Ltd.	Waterford Finance & Investment Limited	March 19, 2008	Partial Win
Fortsum Business Solutions Inc.	Louis Lessard and GMSL Financial S.A.	May 1, 2008	Management Win
Frontier Pacific Mining Corporation	Eldorado Gold Corporation	June 10, 2008	Partial Win
Genco Resources Ltd.	James R. Anderson	June 11, 2008	Partial Win
Gold Port Resources Ltd.	Guayna Goldfields Inc.	September 19, 2008	Partial Win
Golden Dawn Minerals Inc.	Aberdeen Gould	May 13, 2008	Management Win
Green Environmental Technologies Inc.	ENPAR Technologies Inc.	October 10, 2008	Dissident Win
International PetroReal Oil Corporation	Edward Borrelli, Arthur Sulzer, Ernst Schlotter and Nika Management S.A.	July 21, 2008	Dissident Win
International Sovereign Energy Corp.	Eugene Hertzay and Sharad Mistry	June 3, 2008	Dissident Win
Kola Mining Corporation	Stargate Solutions Ltd.	November 2008	Dissident Win
Loring Ward International Ltd.	Werba Reinhard, Inc.	June 9, 2008	Partial Win
Noront Resources Ltd.	Rousseau Asset Management Ltd.	October 8, 2008	Partial Win
Pennine Petroleum Corporation	Jeff Saxinger	April 7, 2008	Dissident Win
Pet Valu Inc.	Goodwood Inc.	April 8, 2008	Partial Win
Ringbolt Ventures Ltd.	Simon C.Y. Tam	November 2008	Dissident Win
Tree Island Wire Income Fund	The Futura Corporation	February 7, 2008	Management Win
U308 Corp.	Aberdeen International Inc.	June 16, 2008	Management Win
WGI Heavy Metals, Incorporated	Passport Capital, LLC	June 3, 2008	Management Win
Zarlink Semiconductor Inc.	Scott Leckie, Daniel Owen, David Banks	July 2, 2008	Management Win

Summary of Canadian Proxy Contests - 2009

Target	Dissident Shareholder(s)	Date of Proposal	Outcome
Athabasca Potash Inc.	CSIT Consulting Inc.	August 26, 2009	Dissident Win
Augen Gold Corp.	Augen Capital Corp.	February 13, 2009	Dissident Win
Biovail Corporation	Eugene Melnyk	May 8, 2009	Partial Win
Canadian Superior Energy Inc.	Palo Alto Investors	May 14, 2009	Partial Win
Carlisle Goldfields Limited	Richard H. Sutcliffe	July 2, 2009	Management Win
Chariot Resources Limited	Brian Edgar and Lukas Lundin	August 18, 2009	Management Win
Citadel Funds (Series S-1 Income Fund, Citadel Premium Income Fund, Citadel S-1 Income Trust Fund, Citadel Diversified Investment Trust and Citadel HYTES Fund)	Blue Ribbon Fund Management Ltd.	September 8, 2009	Partial Win
Clifton Star Resources Inc.	Mineralfields Fund Management Inc.	December 9, 2009	Management Win
		December 22, 2009	
Dorex Minerals Inc.	Juraj Adamec	September 3, 2009	Dissident Win
The Forzani Group Ltd.	Crescendo Investments II, LLC and Crescendo Investments III, LLC	May 13, 2009	Management Win
Harte Gold Corp.	Shareholder Protection Committee of Harte Gold Corp. – represented by John Gable	January 12, 2009	Dissident Win
HudBay Minerals Inc.	SRM Global Master Fund Limited Partnership	March 2, 2009	Dissident Win
McLaren Resources Inc.	Gregory C. Liddy and Brian Berner (the “Liddy-Berner Group”) (existing Directors)	February 3, 2009	Management Win
	Victor H. Childs and Thomas W. Meredith (the “Childs-Meredith Group”) (existing directors)	February 6, 2009	Dissident Win
NEMI Northern Energy and Mining Inc.	Michael Cooney	March 16, 2009	Dissident Win
Polar Star Mining Corporation	Douglas Willock (former President and CEO of Polar Star, and current director)	March 9, 2009	Dissident Win
Rockwell Diamonds Inc.	Pala Investments Holdings Limited	May 20, 2009	Management Win
Route1 Inc.	K. Andrew White (former President and CEO)	August 26, 2009	Dissident Win
Silvermex Resources Ltd.	Sibling Rivalry Investments Inc.	October 20, 2009	Dissident Win
TriNorth Capital Inc.	Tony P. Busseri	May 28, 2009	Management Win
Vangold Resources Ltd.	Gerry Lefevre	June 15, 2009	Management Win
Virgin Metals Inc.	Lucas Ewart	July 14, 2009	Partial Win