

CORPORATE GOVERNANCE REFORMS CHANGING PROXY VOTING RULES

The past year's cavalcade of corporate corruption and fraud shattered investor confidence. Good corporate governance practices have been embraced by the financial community, legislators and regulators as the solution to restoring investor trust. (A rising stock market might also help.) New laws, rules, regulations, and policies being implemented will have an immediate and profound impact on 2003 shareholder meetings. There will be no more "routine" annual meetings.

New Corporate Governance Rating Systems

Corporate governance rating systems are being heralded as a valuable, new tool that will enable investors to evaluate the quality of corporate boards and the impact their governance practices may have on performance. Institutional Shareholder Services (ISS) and its Canadian affiliate, Fairvest, introduced their "Corporate Governance Quotient" system (CGQ) in June 2002. ISS covers the Russell 3000 and plans to expand coverage to all U.S. Companies in 2003. Fairvest covers 1500 Canadian companies. Standard & Poor's also is introducing a new rating system scoring the S&P 500. The Investor Responsibility Research Center (IIRC) and TrueCourse are working with panels of investment professionals moderated by Lutin & Co. to develop an objective and independent scoring system.

Regardless of the validity of these rating systems, pension funds and institutions are signing up. Solomon Smith Barney is now including CGQ scores in its research reports. Other brokerage firms are expected to soon follow suit. Henceforth, corporate governance scores will have an impact on institutional proxy voting decisions. Corporations will have the opportunity to review their rating data before corporate governance scores are issued. For fees ranging upwards from \$10,000 public companies can subscribe to these rating services and, perhaps, improve their scores.

No More "Routine Votes" For Stock Options

Stock options, it is widely believed, facilitated a massive transfer of wealth from investors to management and employees in the 1990s. Shareholders have now been empowered by the Securities and Exchange Commission (SEC) and the New York Stock Exchange (NYSE) to approve all new stock option plans. A recent SEC ruling also enables investors to vote on expensing stock options.

NYSE rules govern the voting of proxies by its member brokerage firms. Since individual investors usually hold their stocks in brokerage accounts, the shares are registered in the name of their brokerage firm ("street name") and voted by the brokerage firm or its agent, ADP Proxy Services, when they receive their client's proxies. Even if a company's shares are listed on NASDAQ, Toronto Stock Exchange or OTC Bulletin Board the voting of the company's proxies by U.S. brokerage firms is still governed by NYSE rules.

In the past, when a public company requested an increase in available stock options that totaled less than 5% of the outstanding shares, U.S. brokerage firms could vote all their customer shares, where no specific instructions had been received, in favor of the stock options. Public companies often gained shareholder approval of their stock option plans without realizing they were being passed by a "routine broker vote" rather than by actual, affirmative votes cast by their shareholders.

On August 1, 2002 the NYSE approved significant changes aimed at strengthening corporate governance practices including requiring all stock option plans and any material revisions of the plans, such as repricing of existing options, must be subject to actual shareholder approval. There will be no more U.S. "routine broker votes" on stock options.

Effective Proxy Solicitation Will Be Essential in 2003

Proxy solicitation will become a major effort for companies seeking shareholder approval of stock options. No longer will it be adequate to hire a mail house to handle the annual meeting. Companies now must actively solicit proxies if they hope to pass their stock option plans. Management also must field a professional team capable of explaining complex and controversial proposals to their shareholders. In addition, the proxy solicitation will require in-depth knowledge of the mechanics of the proxy voting process gained through years of practical experience. Allen Nelson & Co. is well prepared to assist its U.S. and Canadian clients in the 2003 Proxy Season.