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VIA EMAIL

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

Dear Sirs/Mesdames:

Re: Canadian Securities Administrators ("CSA") Consultation Paper 25-401

Thank you for the opportunity to provide comments on CSA Consultation Paper 25-401: Potential Regulation of Proxy Advisory Firms, dated June 21, 2012 (the "**Consultation Paper**").

We act for a significant number of participants in the Canadian capital markets, including public issuers, that are affected by the voting recommendations and corporate governance guidelines of proxy advisory firms. While the issues identified in the Consultation Paper are of significant interest to our capital markets clients, this comment letter is not written on behalf of any particular client or group of clients and the views expressed herein are those of the Bennett Jones lawyers who have participated in the preparation of this letter.

General Comment

We agree with various concerns about proxy advisory firms identified in the Consultation Paper and, in particular, wish to comment on the following: (i) lack of transparency; (ii) inaccuracies and limited engagement with issuers; and (iii) inappropriate influence on corporate governance practices.

As an opening point, we note the significant asymmetry that exists between proxy advisory firms and other capital markets participants that seek to influence voting at meetings of securityholders of Canadian reporting issuers. As a general rule, if a person wishes to influence the outcome of a securityholder vote, that person (whether the incumbent management or a dissident) must solicit proxies and provide a significant level of public disclosure in support of his/her/its position, so as to put persons whose proxies are solicited in a position to form a reasoned judgment with respect to the applicable item(s) of business. The prospect of securities law liability in relation to proxy solicitation materials gives rise to the exercise of considerable care in the preparation of those materials on the part of management and boards of directors (in the case of management proxy circulars) and dissidents (in the case of dissident proxy circulars). Despite the fact that proxy advisory firms appear to have significant influence over the proxy process, they are not held to similar standards, as a result of the exemption that appears in the definition of "solicitation" in securities legislation in force in Canada.

In the Consultation Paper, it was noted that approximately 32% of the shares of TSX-listed issuers are held by institutional investors. We note that, given the low securityholder turnout at issuer meetings in Canada, which is often well below that in other jurisdictions, the 32% held by institutional investors has a significant impact on the overall voting results and consequently any proxy advisory firm making voting recommendations is likely to have a significant effect on voting results. In particular, we have observed large swings in the vote count for securityholder meetings, which appear to be attributable to a change by a proxy advisory firm of its recommendation and a large number of negative votes where a proxy advisory firm has recommended a negative vote on a specific resolution.

For our part, we find it difficult to reconcile this asymmetry with first principles; that proxy advisory firms have the benefit of an exemption that allows them to wield significant influence over proxy voting without being required to publicly justify their position in written materials (as others are required to) is, in our view, incompatible with the fundamental principles that underlie the proxy solicitation regime in Canada. We view this concern as being exacerbated in circumstances where the proxy advisory firm operates a for-profit undertaking.

Specific Comments

Lack of transparency

In our view, improved disclosure regarding the formulation of voting recommendations by proxy advisory firms would be very helpful to the issuers we represent. While issuers and institutional investors are able to subscribe for voting recommendation reports authored by proxy advisory firms, such recommendations do not always appear to be based on a straightforward application of the proxy advisory firm's publicly available policies. A number of firm clients have encountered circumstances in which internal and predefined rules employed by a proxy advisory firm were not set out in its publicly available policy guidelines.[1] In our view, capital markets would benefit from full disclosure regarding the internal rules and policies employed by proxy advisory firms so that issuers have the opportunity to engage constructively and proactively with the proxy advisory firms prior to a potentially negative and damaging recommendation.

Not only should the full spectrum of rules and policies be made publicly available in advance of their application, but the proxy advisory firms' reasons for adopting such rules and policies should also be disclosed in advance of the applicable proxy season, so that issuers and investors can fully question and assess the basis for those rules and policies. Ultimately, a proxy advisory firm's recommendation should be demonstrably linked to previously published voting guidelines.

We acknowledge that institutional investors who hold their interests on behalf of their various clients and beneficiaries have a duty to those clients and beneficiaries. We acknowledge that organizations representing

[1] For example, our clients have experience with proxy advisory firms applying unpublished rules relating to quorum requirements and preferred shares issuable in series. In one circumstance, a negative recommendation was given on the basis that a given proxy advisory firm had developed a policy (albeit unpublished) that blank cheque preferred shares should be limited in number relative to an issuer's outstanding common share capital.

institutional investors emphasize the importance of institutional investors being "active investors", which generally includes the voting of securities on an informed basis. We submit that voting recommendations based on non-public policies and inaccurate information, when coupled with automatic voting, fail to promote responsible, active voting on the part of institutional investors. Enhanced continuous disclosure requirements coupled with increasingly complex business transactions appear to have resulted in increased reliance on proxy advisory firms and consequently the failure of the proxy advisory firms to provide accurate, complete and timely information is of significant concern.

Inaccuracies and limited engagement with issuers

As noted in the Consultation Paper, a 2010 survey of issuers carried out by the Center on Executive Compensation in the United States (regarding inaccuracies in the underlying data used by proxy advisory firms to arrive at their recommendations) found that "of those responding, 53 percent said that a proxy advisory firm had made one or more mistakes in a final published report on the company's compensation programs in 2009 or 2010".[2] We expect the statistics in Canada on this point to be similar to those in the United States, as it is not uncommon for our clients to find inaccuracies in proxy advisory firms' reports. In the Consultation Paper, it was noted that the Securities Commissions have not received any complaints from institutional investors; however, it is our belief that in many circumstances where there are errors in the recommendations and a new recommendation is not issued, institutional investors are unable to appropriately assess the reliability and accuracy of such recommendations.

In our view, the prevalence of inaccuracies in proxy advisory firms' reports, the relatively inflexible and rule-bound approach of proxy advisory firms (which curtails the exercise of judgment) and their reluctance or refusal to correct errors once made aware of them, compromises the ability of shareholders to make informed decisions and militates against the proper functioning of capital markets in Canada.[3] In our view, proxy advisory firms should be compelled to engage with issuers to resolve inaccuracies. Of course, advance notice and response time is critical in that regard – issuers should have the opportunity to correct misinformed recommendations before such recommendations can influence shareholder decisions.

[2] Center on Executive Compensation, *A Call for Change in the Proxy Advisory Industry Status Quo: The Case for Greater Accountability and Oversight*, January 2011, at page 10.

[3] In one instance, a proxy advisory firm issued a recommendation advising the securityholders of a client to withhold from voting for the approval of the issuer's auditors on the basis that the non-audit fees paid by the issuer to its auditors represented in excess of 62.5% of the total fees paid to the auditors in 2009. The proxy advisory firm's recommendation was based on its internal policy of recommending that securityholders withhold votes from the appointment of an audit firm, where "Other Fees" exceed 50% of the total fees paid to the external auditor. At no time did the proxy advisory firm contact the issuer prior to issuing its recommendation. Upon becoming aware of the recommendation, the issuer immediately contacted the proxy advisory firm to explain that the size of the non-audit fees was simply reflective of the issuer's significant capital raising activities and acquisitions during 2009, in which the auditor was required to play a significant role (as mandated by applicable securities legislation), and to explain management's assessment as to why the independence of the auditors was not compromised by those fees. The proxy advisory firm refused to reconsider its initial recommendation. Moreover, during the course of the issuer's discussions with the proxy advisory firm, the analyst at the proxy advisory firm: (i) suggested that the proxy advisory firm would prefer the issuer to *remain inactive* (rather than undertake capital raising activities and acquisitions) so that its auditor's non-audit fees would fall within the proxy advisory firm's guidelines; (ii) advised that the proxy advisory firm does not assess or verify the reasonableness of audit fees; and (iii) indicated that if it happened again they would recommend against the election of directors who are also members of an audit committee. The analyst also advised that the proxy advisory firm would be prepared to recommend that securityholders vote in favour of the appointment of the auditors if the issuer simply doubled the audit fee payable so that non-audit fees would constitute a lower percentage of the total fees paid to the auditors. We find these positions to be inappropriate and irresponsible given the role that proxy advisory firms have created for themselves among certain institutional investors.

In particular, we believe that if a proxy advisory firm proposes to issue a report that contains one or more negative recommendations in respect of an issuer, the proxy advisory firm should be required to provide a draft of the report to the affected issuer three to five business days in advance of finalizing and issuing the report. This would give the issuer an opportunity to engage with the proxy advisory firm regarding any inaccuracies. In addition, if the proxy advisory firm decides not to revise its report, the issuer should have the opportunity to append its rebuttal to the report. This process for issuer engagement would, we believe, improve the accountability of proxy advisory firms and help reduce the occurrence of factual inaccuracies.

In addition, the CSA should consider requiring the proxy advisory firms to submit an annual report to the CSA that summarizes the instances in which an issuer has disagreed with the firm's final recommendation on the basis of factual inaccuracies. The CSA might take such report into consideration when continuing to assess the need for additional regulatory response in the future.

Inappropriate influence on corporate governance practices

In our experience, the corporate governance standards developed by proxy advisory firms have significant influence on the behavior of issuers. To a significant degree, proxy advisory firms have become *de facto* "standard-setters" in respect of corporate governance, and while other governance organizations, such as the Canadian Coalition for Good Governance ("**CCGG**"), have also become *de facto* "standard-setters", CCGG is a not-for-profit organization, its procedures and standards are publicly disclosed, and it engages in a rigorous process for arriving at such corporate governance standards (including the circulation of discussion papers).

We are particularly concerned that a for-profit proxy advisory firm model yields an inherent conflict of interest between transparency and the generation of issuer-derived revenue. We understand that certain advisory firms currently offer issuers fee-based proxy review services. We are aware of circumstances where issuers have retained such services only to guard against a negative vote recommendation derived from unpublished guidelines, or the perceived inconsistent application of published guidelines. Although issuers are advised by proxy advisory firms that a review does not guarantee a positive recommendation, our clients have found that a positive review process generally results in a positive voting recommendation. In this sense, a for-profit proxy advisory firm business model based (at least in part) upon issuer-derived revenue benefits from a lack of transparency by promoting the retention of the proxy advisory firm by issuers as an "insurance policy" against perceived unpredictable outcomes. The rigorous imposition of transparency requirements, coupled with a mandated opportunity for issuer engagement with the proxy advisory firm prior to the publication of a negative vote recommendation, would in our view serve to mitigate the impact of this inherent conflict of interest.

To the extent that for-profit proxy advisory firms operate under discretionary exemptions from the "advisor" registration requirements of applicable securities laws, we would submit that as a condition for the ongoing (or annual) application of such exemption(s), proxy advisory firms (in particular those that derive revenue at least in part from issuer-based fees) submit defined and comprehensive proxy voting guidelines to the securities regulatory authorities and make such guidelines publicly available. A condition of such exemption(s) could also require that negative vote recommendations be derived from such filed guidelines. We note that at least some proxy advisory firms that conduct business in the United States are registered as an investment adviser under the U.S. Investment Advisers Act of 1940 and are therefore also subject to the ongoing supervision of the United States Securities and Exchange Commission.

Any corporate governance standards proposed and ultimately adopted by proxy advisory firms should be publicly disclosed in advance of the applicable proxy season. Moreover, the proxy advisory firms' reasons for adopting their various corporate governance standards should be transparent. Given the influence of proxy advisory firms as governance "standard-setters", their governance standards should be fair and market participants affected by such standards should have the opportunity to question and assess in the public forum the rationale and process for developing such standards.

In addition, it has been the experience of some of our clients that the corporate governance standards adopted by proxy advisory firms reflect a "one size fits all" approach that does not necessarily acknowledge the different circumstances of issuers. We note in particular that in developing their corporate governance standards and related voting guidelines, proxy advisory firms do not appear to take into consideration the unique and legitimate governance differences of controlled companies.

We hope our comments are useful in the development of a regulatory framework applicable to proxy advisory firms and welcome the opportunity to discuss these responses with representatives from the CSA.

Please note that the following members of our Capital Markets Group have participated in the preparation of this letter and may be contacted directly in the event you have any questions concerning our submissions:

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Yours truly,

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