TORYS LLP
NEW YORK TORONTO

Suite 3000
79 Wellington St. W.
Box 270, TD Centre
Toronto, Ontario
M5K 1N2 Canada

TEL 416.865.0040
FAX 416.865.7380

www.torys.com

Jennifer L. Friesen
TEL 416.865.7635
FAX 416.865.7380
jfriesen@torys.com

October 3, 2003

DELIVERED BY EMAIL

Ontario Securities Commission
Alberta Securities Commission
Manitoba Securities Commission
Registrar of Securities, Government of Yukon
Registrar of Securities, Department of Justice,
Government of Northwest Territories
Securities Commission of Newfoundland and Labrador
Nova Scotia Securities Commission
Commission des valeurs mobilières du Québec
Saskatchewan Financial Services Commission
Office of the Attorney General, Prince Edward Island
Registrar of Securities, Legal Registries Division,
Department of Justice, Government of Nunavut
Department of Justice, Securities Administration Branch, New Brunswick

c/o John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, Ontario M5H 3S8

and

Denise Brosseau, Secretary
Commission des valeurs mobilières du Québec
Tour de la Bourse
800, Square Victoria
C.O. 246, 22e étage
Montréal, Québec H3Z 1G3

Dear Sirs/Mesdames:

Re: Requests for Comments on:
- **Proposed Multilateral Instrument 52-109–Certification of Disclosure in Companies' Annual and Interim Filings**
- **Proposed Multilateral Instrument 52-110–Audit Committees**

This is our firm's response to the requests for comments on:

- proposed Multilateral Instrument 52-109–*Certification of Disclosure in Companies' Annual and Interim Filings* (the "**Proposed Certification Rule**[1]") and

- proposed Multilateral Instrument 52-110–*Audit Committees* (the "**Proposed Audit Committee Rule**");

(together, the "**Proposed Rules**"), made on June 27, 2003 by the securities regulatory authorities of Alberta, Saskatchewan, Manitoba, Ontario, Quebec, Nova Scotia, New Brunswick, Prince Edward Island, Newfoundland and Labrador, Yukon, Northwest Territories, and Nunavut.

Support for the Proposed Rules Generally

In general terms, we support the making of the Proposed Rules, believing that they are appropriate in light of the adoption of substantially similar requirements in the United States, under the Sarbanes-Oxley Act of 2002 ("S-Ox").

We believe the Proposed Rules are appropriate for the following reasons:

(a) The Proposed Rules are likely to help maintain and enhance investor confidence in the integrity of our capital markets.

(b) In light of the integration of the American and Canadian capital markets and economies, we believe that any Canadian securities regulatory response to important legislative and regulatory developments in the United States should seek to achieve the following goals, among others:

(i) harmonizing with (but not going beyond) American regulation; and

(ii) demonstrating to market participants and others that Canada's corporate governance regime is no less rigorous than the regime in the United States.

---

[1] Unless otherwise indicated, all references in this letter to "Rules" include the companion policy accompanying the rule.

(c) With respect to (b)(ii), we believe that demonstrating a rigorous corporate governance regime in Canada is important to preserve the unique ease of access to U.S. capital markets enjoyed by Canadian companies through the Multijurisdictional Disclosure System. The continued availability of this and other benefits may depend in large measure on the goodwill of U.S. regulators and lawmakers and their perceptions of Canadian securities regulation. The benefits could be impaired if they perceive Canada's capital markets or Canadian public companies to be weak on corporate governance (or other) matters.

Our comment in (b) above, is not meant to suggest that Canadian securities regulators should simply copy all of the provisions of S-Ox and U.S. stock exchange initiatives. Indeed, the passage of S-Ox and related rules occurred so quickly that a "wait and see" response by Canadian securities regulators was and continues to be appropriate. But Canadian securities regulators can and probably should now adopt corporate governance provisions that, like the Proposed Rules, have something of a track record in the United States and will enhance Canadian capital markets.

I. THE PROPOSED CERTIFICATION RULE

1. Application of the Proposed Certification Rule to Income Funds and Holding Company Structures

In your request for comments on the Proposed Certification Rule, you ask whether the same certification rules should apply to issuers where all or a majority of its business is operated through a subsidiary or another issuer which is controlled by the issuer, such as income trusts.

Generally, the business of an income fund consists of holding debt and equity securities of a private operating entity and distributing the cash received from the operating entity to the unitholders of the fund. In many cases, the income fund has no CEO or CFO and the trustees of the fund would not, in most cases, be in a position to provide the certification.

With respect to the income funds structured in this manner, we would suggest that the CEO and CFO of the operating entity be required to provide the certification for the operating entity, in lieu of certifications in respect of the fund itself. The operating entity certificates would be filed with the fund's filings. Similar procedures could also be adopted for holding companies where all or substantially all of the business is carried on by a subsidiary.

2. Evaluation of Disclosure Controls

Paragraph 4(c) of Form 52-109F1 requires the certifying officers to certify that the effectiveness of the issuer's disclosure controls and procedures have been evaluated "as of the end of the period covered by the annual filings". This requirement is identical to that found in the certificate prescribed by section 302 of S-Ox.

Evaluating the effectiveness of disclosure controls as of the *end* of the period meshes with the U.S. periodic disclosure regime because, with some exceptions, there is no requirement under U.S. securities law to make timely disclosure of material changes on a continuous basis (that is, immediately when material changes happen).

Given the Canadian continuous disclosure regime, however, it seems more appropriate to certify that the disclosure controls are effective *during* the relevant period, and not merely at the *end* of the period.

3. Internal Control Certification

Under section 1.3 of the Proposed Certification Rule, issuers may exclude the certification of internal controls from any annual or interim certificate that is required to be filed before January 1, 2005. For most Canadian companies[2], certification of internal controls therefore will begin for the year-ended December 31, 2004, in the annual filings made in the spring of 2005.

This deadline is earlier than the S-Ox deadline to certify internal controls for Canadian cross-border issuers. Under section 302 of S-Ox, the certifying officers of Canadian cross-border issuers are not required to certify internal control over financial reporting until the first fiscal year ending after April 14, 2005. Therefore, under S-Ox, for most Canadian cross-border issuers[3], certification of internal controls will begin a year later, for the year-ended December 31, 2005, when the annual filings are made in the spring of 2006.

We do not see a compelling reason to impose a Canadian requirement to certify internal controls before Canadian cross-border issuers are required to do so under S-Ox. Indeed, Canadian cross-border issuers arguably could defer the application of the requirement to certify internal controls under the Proposed Certification Rule to the spring of 2006, by relying on the exemption in section 4.1(1) for the 2004 annual filings and by voluntarily filing interim certifications for fiscal 2005 with the SEC[4] and relying on sections 4.1(2) and (3) of the Proposed Certification Rule as currently drafted.

We note that subsection 4.1(3) of the Proposed Certification Rule is not qualified by provisions similar to those in sections 4.1(4) and 4.1(5). It was not clear to us if this was intentional.

4. Comments on Forms 52-109F1 and 52-109F2

Paragraph 5(a) of both Forms 52-109F1 and 52-109F2 require the certifying officers to certify that they have reported to the external auditors and the audit committee "all

---

2 That is, those that have December 31 year-ends.

3 See note 2.

4 Under S-Ox, Canadian cross-border issuers are not required to certify internal controls for interim periods.

significant deficiencies and material weaknesses in the design or operation of internal controls that could adversely affect the issuer's ability to disclose information required to be disclosed by the issuer under applicable provincial and territorial securities legislation …" It appears to us that the concepts of *internal controls* and *disclosure controls* are mixed in these paragraphs. We suggest replacing paragraph 5(a) with the following wording:

> "all significant deficiencies and material weaknesses in the design or operation of internal controls that are reasonably likely to adversely affect the issuer's ability to record, process, summarize and report financial information; and"

5. Additional Drafting Comments on the Proposed Certification Rule

You may wish to consider the following drafting points:

- preamble to paragraph 4.1(1) of the Proposed Certification Rule – for consistency and clarity, we suggest adding the italicized word to the following phrase: "…with respect to the relevant *annual* period if…" (because the preamble to section 4.1(2) uses the phrase *interim* period).

- Part 4 of the Companion Policy – we suggest adding the italicized words to the following phrase: "... certify that their issuer's financial statements *and other financial information* "fairly present" the financial condition of the issuer ...". This will clarify that it is the whole package of financial information that must "fairly present", and not merely the financial statements, which must still "fairly present in accordance with GAAP".

- Part 4 of the Companion Policy – we suggest changing the last sentence of the first paragraph to read: "... particularly where the results of *the GAAP financial statements* may not reflect ...".

II. THE PROPOSED AUDIT COMMITTEE RULE

1. Application of the Proposed Audit Committee Rule to Income Funds and Holding Company Structures

The Proposed Audit Committee Rule, as drafted, applies only to reporting issuers. In the income fund and holding company contexts, the public issuer would comply with the requirements and no additional requirements would be imposed at the operating entity level.

With respect to income funds, the full board of trustees often serves as the fund's audit committee for purposes of reviewing the financial statements of the fund. Typically, there is also an audit committee at the operating entity level. In many cases one or more trustees of the income fund is also a member of the operating entity's audit committee, but the composition of the operating entity audit committee and the trustees of the fund is not entirely the same.

If the Proposed Audit Committee Rules are applied at the operating entity level, the composition of many of these audit committees may have to change, particularly where the former controlling shareholders of the operating entity retain a substantial interest in the operating entity. In these cases, members of the operating entity audit committee who are appointed by the former controlling shareholders may not be "independent" for purposes of the Proposed Audit Committee Rule, either by virtue of ongoing consulting, advisory or other fees, or by being an "affiliated entity" of the income fund, or both.

We agree that the Proposed Audit Committee Rule should apply only to the income fund and not also to the operating entity. However, where there is a separate audit committee at the operating entity level, we believe that it is important for the income fund to have at least one representative on the board of directors and audit committee of the operating entity. This will ensure that the trustees will have a sufficient understanding of the financial statements of the operating entity to enable them to fulfill their audit committee obligations at the fund level. We believe that the same requirements should apply to holding companies.

2. Application of the Proposed Audit Committee Rule to Subsidiary Entities

Subsidiary entities that have no equity securities trading on a marketplace are exempt from the Proposed Audit Committee Rule if the parent corporation is subject to the requirements of the rule (subsection 1.2(d)). We think this exemption should be expanded to include those situations where the parent is subject to equivalent provisions under SEC rules.

3. Definition of Independence

(i) Does Shareholding Taint Independence?

The New York Stock Exchange's view is that shareholding alone will not taint independence.

The TSX's guidelines on corporate governance have a similar provision. Section 5.12 of the December 1994 *Report of The Toronto Stock Exchange Committee on Corporate Governance in Canada* states that "a director who is a significant shareholder or a director with interests in or relationships with the significant shareholder should not be considered a related director" for the purposes of the TSX guidelines. Shareholding alone will not make a director "related".

Yet, the definition of independence in the Proposed Audit Committee Rule does not expressly contain this carve-out. We think it should, and we think the provision in section 3.3, which provides a concession to controlled companies needs some amplification or clarification. The Notice and Request for Comments poses a specific question (Part 3, question 4) as to whether the exemption in section 3.3 of the Proposed Audit Committee Rule is required in light of the definition of "affiliated entity". We have not reached consensus on this technical

question.[5] We are in agreement, however, that a clear, stand-alone articulation of what is and what is not permitted in the context of controlled companies is desirable. To require market participants to parse the complex definition of "affiliated entity" and apply it to the provisions on independence is likely to result in some confusion and different interpretations.

(ii) Immediate Family Members

We believe that the definition of "immediate family member" in section 1.1 is too broad and has the effect of disqualifying too many directors from being independent. For example, a director will be deemed not independent if his brother-in-law is an executive of a company which has on its compensation committee the CEO of the issuer. It is not obvious to us that the director's independent judgment will be impaired in every situation like this.

We suggest that "immediate family member" be restricted to the individual's spouse, parent, child and anyone (other than an employee of the individual or immediate family member) who shares the individual's home. If the director's siblings or in-laws have material relationships that would interfere with the director's independent judgment, then the director would fail the general independence test in subsection 1.4(1).

(iii) Use of the Term "Limited Partner"

Paragraphs 1.4(3)(b) and (c) deem directors to lack independence if they are or were a partner of a current or former internal or external auditor during certain prescribed periods. Paragraph 1.4(5) refines the definition of "partner" to exclude "a limited partner whose interest in the internal or external auditor is limited to the receipt of fixed amounts of compensation ...". We question the use of the term "limited partner" in paragraph 1.4(5). "Limited partner" has a specified legal meaning under the limited partnerships acts of various provinces and, to our knowledge, no accounting firms are organized as limited partnerships. Perhaps a better term is "fixed income partners".

(iv) Indirect Acceptance of Consulting, Advisory or Other Compensatory Fee

Subsection 1.4(7) is reproduced below:

> "For the purposes of clause 3(e), the indirect acceptance by a person of any consulting, advisory or other compensatory fee includes acceptance of a fee by
>
> (a) an immediate family member, or

---

[5] Some of us feel that section 3.3 does not provide any relief to controlled companies in addition to that which flows from the definition of "affiliated entity". Indeed, section 3.3 may have the opposite effect, by reining-in the number of individuals that would qualify as independent to serve on the audit committee. For example, a non-employee director of a parent will not be an "affiliated entity" of the issuer, but he or she might have other relationships that would taint his or her independence vis-à-vis the parent company. These other relationships may disqualify the director from serving on the issuer's audit committee under section 3.3.

(b) a partner, member or executive officer of, or a person who occupies a similar position with, an entity that provides accounting, consulting, legal, investment banking or financial advisory services to the issuer or any subsidiary entity of the issuer, *other than limited partners, non-managing members and those occupying similar positions who, in each case, have no active role in providing services to the entity*."

It is unclear to whom the italicized words in (b) relate. While the sensible interpretation is that they relate to the audit committee member, they could also be read to relate to the partner, member or executive of the entity that received the fee. We have the same concern with the use of the term "limited partner" in paragraph 1.4(7)(b). In addition, it is unclear to us what the term "non-managing member" means.

We would suggest rewording paragraph 1.4(7)(b) as follows:

"an entity in which the person is a partner, member, executive officer, or occupies a similar position (except fixed income partners, non-managing members and those occupying similar positions who, in each case, have no active role in providing services to the entity) and which provides accounting, consulting, legal, investment banking or financial advisory services to the issuer or any subsidiary entity of the issuer."

(v) Affiliated person

We note that there is some overlap between sections 1.4(3)(a) and (f) in that employees are caught under both the "employee" and "affiliated person" headings.

4. Compensation of the External Auditors

As drafted, paragraph 2.3(2)(b) of the Proposed Audit Committee Rule requires the audit committee to recommend to the board of directors the compensation that should be paid to the external auditors. The issuer would be required to disclose any instances where the board did not follow the audit committee's recommendation. This differs from the approach taken by the SEC, where the audit committee directly establishes the auditor's compensation. According to the Notice and Request for Comments that accompanied the Proposed Audit Committee Rule, you were not able to adopt the U.S. approach due to constraints in Canadian corporate law.

We believe that the *Canada Business Corporations Act* permits the audit committee to set the compensation of the external auditor in cases where the shareholders have not fixed the auditor's compensation. Subsection 162(4) of the *CBCA*, for example, provides that the remuneration of an auditor may be fixed by ordinary resolution of the shareholders, or, if not fixed by the shareholders, it may be fixed by the directors. If the shareholders have not set the auditor's compensation (as is usually the case), the board can delegate this responsibility to the audit committee under subsection 115(1) because it is not one of the actions that is expressly

prohibited under subsection 115(2)[6]. Of course, non-corporate issuers, such as trusts and limited partnerships, may also vest this responsibility in their audit committee.

It would be preferable to restructure the Proposed Audit Committee Rule to permit issuers to choose one of the following regimes if the shareholders do not fix the auditor's compensation:

(a) require the audit committee to set the compensation of the external auditor and require disclosure in Form 52-110F1 and F2 that the audit committee has set the auditor's compensation; or

(b) require the audit committee to recommend to the board of directors the compensation of the external auditors and require disclosure in Form 52-110F1 and F2 of any instances where the board has not followed the audit committee's recommendation.

5. Designation of Audit Committee Financial Experts

We have three concerns with the requirement that issuers identify audit committee financial experts.

First, imposing this requirement is likely to make it politically unacceptable for companies to not have an audit committee financial expert on their audit committee. If having an audit committee financial expert becomes the norm (as seems to be happening in the United States), lawyers will be advising companies that they must have an expert on their audit committees to meet the new standard. If this is the likely result, then we suggest that the requirement to identify an audit committee financial expert is in practical terms a requirement to have an audit committee financial expert. If this is the case, it is reasonable to suggest that the rule should do directly what it is attempting to do indirectly. If the rule is considered in this light, we have concerns that the definition of audit committee financial expert is so restrictive that it can only be satisfied by a Chartered Accountant who has practiced in the industry in which the particular issuer is engaged. We believe this is too high a standard, and we wonder if there will be enough "audit committee financial experts" in Canada to go around. It is also not clear to us that the cost-benefit analysis of this aspect of the Proposed Audit Committee Rule has been done on the basis that it is likely to, in practical terms, *require* an audit committee financial expert.

---

[6] The same conclusion is likely true under the *Business Corporations Act* (Ontario), although we are researching this question now. Counsel should be encouraging companies to change the standard wording contained in notices of annual meetings to expressly contemplate delegation of the ability to fix auditor compensation by the directors to audit committees. Also, companies would have to review their by laws to ensure that this delegation is permitted.

Second, contrary to section 4.2 of the Companion Policy (and a similar statement by the SEC), we believe it likely that the identification of an audit committee financial expert *per se* will lead to a higher standard of care on that expert.

Third, the identification by the issuer may be misleading to investors, in the sense that they will rely on the issuer's assessment. The identification by the issuer of an "expert" is likely to be relied on investors, and may cause investors to not examine the qualifications of each audit committee member to assess whether the committee as a whole is adequately imbued with the requisite level of expertise.

As a result of all three concerns, our preferred approach would be to see a requirement on issuers to provide detailed, non-boilerplate disclosure about the qualifications of each member of the audit committee, but stop short of identifying whether or not the person is an expert.

However, if the current proposal moves forward, it should be recognized that Item 3 of Form 52-110F1 merely requires the issuer to *disclose the identity* of any audit committee financial expert(s) serving on the committee. Although the issuer must assess whether the members of the audit committee meet the definition, no *designation* is required by the issuer. Section 4.2 of the Companion Policy, however, refers to the "designation or identification" of a person as an audit committee financial expert. The word "designation" should be deleted, because it could lead some to believe that the issuer has the option of designating the audit committee financial experts.

6. Additional Comments on the Proposed Audit Committee Rule

We have identified the following minor points that you might wish to clarify:

- Section 2.4(a) of the Proposed Audit Committee Rule – we suggest changing "revenues paid" to "fees paid".

- Form 52-110F1, Item 6 (and Form 52-110F2, Item 4) – the wording in these items is incomplete. We suggest adding the italicized words, as follows:

  > "If the audit committee has adopted specific policies and procedures for the engagement of *the external auditor to provide* non-audit services, describe those policies and procedures."

- Form 52-110F1, Item 7 (and Form 52-110F2, Item 5) – the period for which fees must be disclosed should be clarified. Is it the intention to disclose fees "billed in" each of the last two fiscal years or "billed in respect of" each of the last two fiscal years?

- Section 5.1 of the Companion Policy – we suggest changing this section to the following (changes and additions are italicized):

> "Subsection 2.3(4) of the Instrument requires an audit committee to pre-approve *all* non-audit services *to be provided by the external auditor*. In our view, it may be sufficient for an audit committee to adopt specific policies and procedures for the engagement of *the external auditor to provide* non-audit services where
>
> - the pre-approval policies and procedures are *documented*, ..."

* * * * *

We appreciate the opportunity to comment on the Proposed Rules and would be pleased to discuss any aspect of this submission with you.

Yours truly,

Jennifer L. Friesen

cc: Torys LLP:

Peter Jewett
Robert Karp
Kevin Morris
Jamie Scarlett
James Turner