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Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Department of Justice, Securities Administration Branch,
New Brunswick
Nova Scotia Securities Commission
Office of the Attorney General, Prince Edward Island
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Government of Yukon
Registrar of Securities, Department of Justice,
Government of Northwest Territories
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Dear Sirs/Mesdames:

**Re: Proposed Regulation of Corporate Governance Disclosure**

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

- proposed Multilateral Instrument 58-101, *Disclosure of Corporate Governance Practices* (the "**January Disclosure Rule"**) and proposed Multilateral Policy 58-201, *Effective Corporate Governance* (the "**Best Practices Policy**") published on January 16, 2004 by the securities regulatory authorities of Alberta, Saskatchewan, Manitoba, Ontario, New Brunswick, Nova Scotia, Prince Edward Island, Newfoundland and Labrador, Yukon, Northwest Territories, and Nunavut (together, the "**January Proposals**"); and

- proposed Multilateral Instrument 51-104, *Disclosure of Corporate Governance Practices*, published on April 23, 2004 by the securities regulatory authorities of British Columbia, Alberta and Quebec (the "**Alternate Disclosure Rule**").

**SUPPORT FOR THE JANUARY PROPOSALS GENERALLY**

We support the disclosure-only nature of both the January Proposals and the Alternate Disclosure Rule, but believe that the January Proposals will result in more meaningful disclosure and will be more likely to result in improvements in the governance structure of many reporting issuers.

The adoption by the Toronto Stock Exchange of the 14 guidelines and disclosure requirement recommended by the Dey Report produced varying results in terms of corporate governance disclosure. There is the sense that some of the current disclosure is unhelpful boilerplate and non-compliance with the TSX's disclosure requirements was not effectively sanctioned by the TSX.

As discussed in the next section, we believe that the January Proposals will result in better disclosure than under both the (i) TSX guidelines, because securities regulatory authorities have enforcement powers not available to the TSX; and (ii) the Alternate Disclosure Rule, because disclosure against written best practices is likely to leave less disclosure discretion in the hands of issuers and less enforcement discretion in the hands of regulators.

**Disclosure, As Measured Against Best Practices**

As between the January Proposals and the Alternate Disclosure Rule, we favour the January Proposals. The recommendations in the Best Practices Policy are not controversial and are rapidly becoming the generally accepted minimum standards of good governance, both by U.S. stock exchanges and Canadian institutional investors. With any set of best practices there is a risk that a check-the-box mentality will develop. However, we think this risk is mitigated by allowing issuers to deviate from best practices when a good reason is provided.

We do not feel that innovation will be stifled by the Best Practices Policy—we would not expect issuers to be penalized by the market when they adopt other practices that are better suited to their needs if they clearly articulate their reasons for doing so. The lack of a benchmark against which to compare practices, as in the Alternate Disclosure Rule, will not encourage innovation; but it will permit those issuers who do not take governance seriously to pay less attention to their practices. It is often difficult for directors to stand-up to a dominating personality unless they have a legal "stick". The January Disclosure Rule provides this stick.

Furthermore, we favour the "comply or explain" approach of the January Proposals because that regime will help Canada demonstrate to market participants that our corporate governance regime is as robust as the U.S. regime. The recommendations in the Best Practices Policy are in line with the mandatory listing requirements of the major U.S. stock exchanges. But, because the practices are optional in Canada, they are already viewed as less rigorous than those south of the border. To abandon a comparison with best practices, as is the case with the Alternate Disclosure Rule, would negatively impact the credibility of the Canadian capital markets internationally.

In the request for comments on the Alternate Disclosure Rule, the British Columbia, Alberta and Quebec regulators state that it is not their intention to oblige issuers to comply with two different sets of standards. We echo this sentiment and urge you to adopt one national approach with respect to this important issue.

**SPECIFIC COMMENTS ON THE JANUARY PROPOSALS**

**Best Practices Policy**

*Application of Policy*

Consideration should be given to revising section 1.2 of the Best Practices Policy to address some of the concerns expressed by the British Columbia, Alberta and Quebec regulators in the request for comments on the Alternate Disclosure Rule. We suggest clarifying that:

(a) the reason for the best practices policy is not to make the practices *de facto* requirements, but is to force issuers to explain to investors their reasons for not following them; and

(b) companies are encouraged to adopt additional governance practices that they consider appropriate for their business and to disclose what those additional practices are.

*Definition of Independence*

We recommend that the full meaning of "independence" be set out in section 2.1 of the Best Practices Policy and section 1.2 of the January Disclosure Rule, rather than referring to selected parts of the meaning as set out in Multilateral Instrument 52-110, *Audit Committees* (the "Audit Committee Rule"). In our view, fewer interpretation issues will arise if the complete meaning is set out in the Best Practices Policy and the January Disclosure Rule.

Our technical comments on the meaning of independence are as follows:

(a) The overarching test for independence is whether the individual is considered to have a material relationship with the "issuer". This gives rise to two major questions:

- Should "issuer" be broadened to include all entities in the consolidated group with the issuer (i.e., a parent company, subsidiaries of the issuer, and perhaps the issuer's sister companies)? We note that for purposes of the NYSE corporate governance listing standards, references to the "company" in the independence standards include any "parent or subsidiary in a consolidated group with the company."[1] This same point can be made about the Audit Committee Rule, but it is of somewhat less importance since the "affiliated entity" test provides some vertical scope to the independence definition.

- How does shareholding impact on independence? Given the large number of closely-held issuers, specific guidance on this point is needed. We note that the New York Stock Exchange has stated that "as the concern is independence from management, the Exchange does not view ownership of even a significant amount of stock, by itself, as a bar to an independence finding".[2] A similar comment is needed in the definition of independence in the January Proposals. It would also be helpful for you to provide examples of how both individual controlling shareholders, and officers and directors of corporate controlling shareholders should be categorized.

(b) With respect to "material relationships", it may be clearer to provide that a material relationship means a "relationship which could, in the view of the issuer's board, *reasonably be expected to* interfere with the exercise of a director's independent judgment."

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[1] General Commentary to section 303A.02(b) of the NYSE Listing Standards. It is not, on its face, clear whether the expanded meaning of "company" under the NYSE listing standards includes sister companies.

[2] Commentary to section 303A.02(a) of the NYSE Listing Standards.

(c) There are a number of clarifications that would be desirable in the wording of the specific bars to a finding of independence in section 1.4(3), and related sections, of the Audit Committee Rule. These are:

- There are many references to the "issuer". As noted above, should these be broadened to include all entities in the consolidated group?

- "Executive officers" of the issuer and their immediate family members will be barred from being classified as independent. If the term "issuer" is not expanded to include parent and subsidiary entities, guidance should be provided in the Best Practices Policy on when an officer of a parent or subsidiary will be an "executive officer" of the issuer by virtue of exercising a policy-making function for the issuer.

- Will the three year "look-back" period begin on March 30, 2004 (when the Audit Committee Rule came into force), or will it begin on the date the January Proposals come into force?

- An individual who is an "affiliated entity" of a current or former internal or external auditor will be barred from being classified as independent. We believe that the safe harbour in section 1.3(4) of the Audit Committee Rule contains a couple of glitches:

  - the preamble should read "…a person will not be considered *to control another person or company* for the purposes of [*the definition of affiliated entity*]…"; and

  - "issuer" in section 1.3(4)(b) should be expanded to cover the broader consolidated group.

- An individual who "receives, or whose family member receives, more than $75,000 per year in direct compensation" is considered to have a material relationship with the issuer under section 1.4(3)(f)(ii). We understand that this test is intended to be backward-looking (to complement section 1.4(3)(f)(i), which we understand is intended to be forward-looking). If our understanding is correct, "receives" should be changed to "received".

We agree that independence should have a consistent meaning in the Audit Committee Rule and in the January Proposals, with the exception of the two aspects that are intended to be carved out (i.e., the "no compensation" test and the "affiliated entity" test). Therefore, any changes which are made to the meaning of independence for purposes of the January Proposals should also be made to the Audit Committee Rule at the first opportunity.

*Nomination of Directors*

The Best Practices Policy sets out a number of factors that the nominating committee should consider in identifying individuals qualified to become new board members and recommending new director nominees. We believe that the nominating committee should also be directed, in section 2.14, to consider the independence status of potential nominees. Consideration should be given to whether the individual would be independent under the

definition of independence in the Best Practices Policy/January Disclosure Rule and, where applicable, the Audit Committee Rule.

*Integrity of CEO and a Culture of Integrity*

It would be useful for you to provide some guidance on the steps, if any, that should be taken to assess the integrity of the CEO and other senior officers, as is recommended in section 4(a) of the Best Practices Policy. What should the board assess? Presumably, the board is not required to investigate the senior officers before any evidence of a lack of integrity, but rather they are required to respond only when red flags are raised about the integrity of these persons. Clarification of this issue would be helpful.

*Corporate Governance Committee*

We believe that section 4(g) of the Best Practices Policy should be amended to reflect the best practice of having a corporate governance committee, which is composed entirely of independent directors. We note that the NYSE listing standards require a fully independent nominating/corporate governance committee.[3]

**January Disclosure Rule**

*Implicit Waivers from the Code of Business Conduct and Ethics*

We believe that the definition of implicit waiver in section 1.1 of the January Disclosure Rule should read as follows: "…means the board of director's failure to take action within a reasonable period of time *after learning of* a material departure from a provision of a code of business conduct and ethics." Consideration could then be given to deleting section 2.3(4) of the January Disclosure Rule. This change would align the definition of implicit waiver with that adopted by the U.S. Securities and Exchange Commission, which requires knowledge of the non-compliance.[4]

*Disclosure of Waivers from the Code of Business Conduct and Ethics*

Item 9 of section 2.2 of the Best Practices Policy recommends that the board of directors approve all waivers granted to directors and senior officers. The corresponding disclosure requirements in section 2.3(3) of the January Disclosure Rule, item 5(b) of Form 58-101F1 and item 3(b) of Form 58-101F2 require disclosure of waivers granted in favour of a director or officer. For the sake of consistency, the approval requirement should be broadened to include all officers, or the disclosure requirement should be restricted to "senior officers".

*Application of Disclosure Rule to Issuers Without Listed Equity*

The Audit Committee Rule does not apply to a subsidiary entity that is a reporting issuer if (a) it has no equity securities trading on a marketplace, and (b) its parent company

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[3] Section 303A.04 of the NYSE Listing Standards.

[4] Item 7 of the Instructions to Item 16b of Form 20-F.

complies with the rule or the comparable U.S. rules. The January Disclosure Rule does not contain a similar exemption.

Other than the regulation of audit committees and certain disclosure items (such as the code of ethics for senior financial officers and the disclosure of "audit committee financial experts"), governance in the United States is regulated by the stock exchanges. The NYSE does not apply its corporate governance listing standards to entities that do not have common equity securities listed on the exchange. We question whether any issuer (whether or not it has a parent that complies with the rule) that does not have equity securities traded on a marketplace should be required to comply with the January Disclosure Rule.

*Location of Disclosure*

A non-Venture Issuer is required to provide the Form 58-101F1 disclosure in its Annual Information Form and must include a reference to this disclosure in its management information/proxy circular. We believe that the descriptive aspects of the Form 58-101F1 disclosure should be made in a document that is delivered to security holders and we suggest that the disclosure be required in the management information/proxy circular. If proxies are not solicited, then disclosure should be required in the AIF. The board mandate, committee charters, and code of business conduct should be filed separately on SEDAR and posted on the issuer's website. The management information/proxy circular should be required to inform investors of this fact and provide the internet address where the documents can be found.

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We appreciate the opportunity to comment on the January Proposals and the Alternate Disclosure Rule and would be pleased to discuss any aspect of this submission with you.

Yours truly,

*"Jennifer L. Friesen"*

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