

Nov. 23/06

Dear Louis,

Below is a summary of the core observations made by a few members of the committee in a conference call during which the adoption of proposed Multilateral Instrument 61-101 was discussed specifically. The committee members who took part in the conference call were Benjamin Silver, Léonard Sérafini, Francis Legault, Charles Spector and myself.

Our discussions focussed on the two issues for which comments were being requested in particular, namely, service agreements with a related party and the prohibition against independent directors receiving special benefits. In this regard, our observations may be summarized as follows:

1. Service Agreements with a Related Party

Generally speaking and based on our experience, most issuers that enter into valuable service agreements with a related party set up governance practices that draw on an independent committee and the opinions of experts to help determine any consequences that such agreements might generate, especially when such agreements are perceived to have a potentially significant impact on corporate affairs. This approach stems from the spirit of current governance guidelines and Supreme Court jurisprudence that now sets out specific benchmarks so that a board of directors can benefit from the defence of business judgment. We therefore do not believe it is necessary to enact specific legislation as put forth in the proposed Instrument. (*Québec Advisory Committee*)

The proposed Instrument raises major issues, including in connection with the valuation of services or agreements that may be exempt from approval from minority security holders, in particular on the basis of 25% market capitalization. In practice, it would be very difficult for a board of directors to value such service agreements by itself, particularly where the amount is payable annually and, in addition, where the amount varies annually based on various factors. In our opinion, the issues related to determining the fair value of service agreements are the primary reasons that prompted regulatory authorities not to require a formal valuation of such agreements. (*Québec Advisory Committee*)

In light of the foregoing, we believe that boards of directors should retain the services of financial consultants in this regard. The fees incurred would be significant, in particular with respect to agreements in which amounts or conditions are not clearly material for the issuer. (*Québec Advisory Committee*)

If the proposed Instrument were adopted, measures such as a grandfather provision should be taken to ensure that all service agreements in effect at the time the Instrument comes into force are protected. Acquired rights would be lost if an agreement is amended subsequent to the coming into force of the new Instrument. (*Québec Advisory Committee*)

All in all, we believe that the proposed characterization of service agreements as related party transactions is too vague and that the usefulness of extending the scope of the Instrument to this type of agreement, or the need to do so, has not effectively been demonstrated. (*Québec Advisory Committee*)

2. Prohibition against Independent Directors Receiving Special Benefits

We have serious reservations regarding this proposed amendment, especially in light of the reasons that seem to underlie the position of the regulatory authorities in this regard. It is difficult to understand why a payment made after a transaction has been completed, and where no indication, negotiation, proposal or request in this regard took place during the transaction, would subsequently undermine the process followed by the independent directors when reviewing the transaction. (*Québec Advisory Committee*)

In our opinion, it is inappropriate and inadvisable for a decision-making process conducted by an independent committee in accordance with rulings handed down recently by Canadian courts to be challenged by a subsequent action over which the directors have no control, and we suspect that directors sitting on independent committees would be particularly concerned about the consequences of such a development. (*Québec Advisory Committee*)

However, inasmuch as the regulatory authorities seek to adopt such a rule, committee members should be the only independent directors being targeted. Indeed, we do not see why an independent director who does not sit on the independent committee would be targeted by the rule. As well, we believe it would be appropriate to set aside specific exceptions to ensure that certain

types of transactions or activities are not deemed to be a special benefit under the new provision. For instance, the continuation of an independent director's term at a combined company should specifically be excluded, and even more so where maintaining such a term is intended to comply with certain legislative or regulatory rules in respect of Canadian companies. Furthermore, we believe it is advisable to introduce some of the exceptions set out in paragraph c of the definition of "collateral benefit," particularly in subclauses i, ii and iv, it being understood however that independent directors should not be expected to undertake a complex exercise for the purpose of determining the value of benefits conferred on them. In this regard, we note that the criteria stipulated in iv (B) are particularly difficult to apply in practice, and that the words "acting in good faith," where the independent committee must itself determine the value of the benefit, clearly indicates that it must seek the advice of an expert in order to benefit from the defence of expertise and fulfill its duty of acting in good faith in the best interests of the company, as upheld again recently by the Supreme Court. Otherwise, the exercise would become an exercise in which independent directors are required to reach a conclusion by themselves as to the benefit to be conferred on other independent directors. We do not believe that any abuses have taken place that would warrant such a procedure or burden.
(Québec Advisory Committee)

Feel free to contact us if you or AMF staff wish to discuss this matter further.

Yours truly,

