EMERSON ADVISORY
SUITE 3600, TD BANK TOWER
66 WELLINGTON STREET WEST
TORONTO, ONTARIO, CANADA M5K 1N6

H. GARFIELD EMERSON
PRINCIPAL

DIRECT 416 865 4350
DIRECT FAX 416 865 4462
gemerson@emersonadvisory.com

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To: 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
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 the Northwest Territories
Registrar of Securities, Legal Registries Division, Department of Justice,
Government of Nunavut

c/o Me Anne-Marie Beaudoin, Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal (Québec) H4Z 1G3
email. consultation-en-cours@lautorite.qc.ca

- and -

c/o John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, Ontario M5H 3S8
email. jstevenson@osc.gov.on.ca

Re: Request for Comment – Proposed Repeal and Replacement of National Policy 58-201 *Corporate Governance Guidelines*, National Instrument 58-101 *Disclosure of Corporate Governance Practices*, and National Instrument 52-110 *Audit Committees* and Companion Policy 52-110CP *Audit Committees*

Dear Sirs/Mesdames:

Thank you for the opportunity to provide comments on the Proposed Materials. My comments are limited to selected areas of the Proposed Materials.

1. **Principles-Based Policy Approach for Governance Guideline Standards**

I support the proposed principles-based policy approach for governance guideline standards as a positive development and an appropriate step forward. While compliance is voluntary from a regulatory perspective, the TSX-originated set of specific corporate governance guidelines in the Current Materials, coupled with the mandatory 'comply or explain' disclosure regime against such specific guidelines, result, in practice, in a prescriptive model of corporate governance for Canadian issuers. Such a prescriptive model ignores the maxim that 'one size does not fit all', begets a 'check the box' mentality of compliance and stifles the initiative of boards of directors to think through and tailor their own governance structures and practices to meet the particular needs of their respective companies. Individuals who have significant actual experience serving on the boards of public companies recognize that the quality of corporate governance does not depend on adherence to a single set of rules or guidelines. Conversely, those issuers that obtain high marks from commentators because of formal compliance with a specific set of rules or guidelines may not, in actual practice within the board room, produce the behavioural outcomes that are reflective of sound corporate governance principles and procedures. A 'comply or explain' mandatory disclosure requirement against a specific set of guidelines also creates an artificial sense of security of 'best practices' and leads to an emphasis on the external form of corporate governance structures over the internal substance and quality of corporate governance practices. While policies and procedures, and, in certain areas, regulations[1] are necessary to provide a framework within which productive and effective corporate governance systems can operate for the benefit of investors, the CSA is right to focus on the underlying principles that are essential for the development of healthy corporate governance cultures.

It is appropriate to note that the National Association of Corporate Directors in the United States (NACD) has recently recommended a principles-based approach, commenting that "legitimate concerns" have arisen "about the overly prescriptive use of best practice recommendations by some proponents, without recognition that different practices may make sense for different boards and at different times given the circumstances and culture of a board and the needs of the company." *Key Agreed Principles to Strengthen Corporate Governance for U.S. Publicly Traded Companies* (2009). The Business Roundtable has supported the *Key*

[1] I think that it is appropriate to regulate the composition and responsibilities of audit committees of reporting issuers. Corporate law in Canada commenced a minimal statutory requirement for audit committees several decades ago.

Agreed Principles, which, it stated, "recognize the importance of independent boards and acknowledge that no one type of governance structure is appropriate for every corporation."

2. **Proposed Governance Materials– Principle 2**

It is evident that the Proposed Materials provide and the Proposed Governance Policy recognizes that a majority, or even all, of the independent directors may be individuals who are, or who are related to, a control person or significant shareholder of the issuer and that a control person, significant shareholder or individual related to them may be the independent chair of the board of directors or lead director. The only caution or limitation in this regard in the Proposed Governance Materials is contained in paragraph (c) of 'Practices related to composition of the board', under 'Examples of practice' in Principle 2 of the Proposed Governance Policy. Paragraph (c) provides guidance that the objective of "Principle 2 – Structure the board to add value" may be achieved including by: "having an appropriate number of independent directors who are unrelated to any control person or significant shareholder;."

In light of the importance of transparency to stakeholders and investors concerning independence of members of the board and their respective relationships, I would suggest the following amendments to the disclosure requirements under Principle 2 of proposed Form 58-101F1 to the Proposed Governance Instrument. Disclosure and transparency serve as significant factors to reinforce board independence and provide an important understanding to investors of how the board interprets the criteria of independence for its directors. There should be clear disclosure with respect to any director who is considered independent of any relationship that director may have with any control person or significant shareholder. This recommendation is consistent with and reflective of the factors referred to in section 3.1 'Guidance for assessing independence' in Part 3 Independence of the Proposed Audit Committee Policy that relate to relationships with affiliates of the issuer.

(a) Amend proposed Form 58-101F1 in sub-paragraph (d)(i) under Principle 2 to read:

"a description of any relationship with the issuer, <u>any affiliated entity[2], a subsidiary entity or a significant shareholder of the issuer or any of their respective executive officers</u> that the board considered in determining the director's independence; "

(b) Amend proposed Form 58-101F1 by adding a new sub-paragraph (d)(iii) as follows:

"<u>identify the directors considered by the board to be independent who do not have any relationship with the issuer, an affiliated entity, a subsidiary entity or a significant shareholder of the issuer or any of their respective executive officers.</u>"

[2] The definition of "affiliated entity" should be continued from the Current Audit Committee Instrument and not deleted in section 1.3 of the Proposed Audit Committee Instrument and such a definition should be incorporated throughout the Proposed Governance Materials.

3. **Proposed Governance Materials – Principle 5**

The 'Practices related to code of conduct' under 'Examples of practice' to Principle 5 of the Proposed Governance Policy properly emphasize the importance of the board of directors adopting and supervising and ensuring compliance throughout the issuer with a code of conduct and ethical behaviour. Paragraph (c) of Principle 5 in the Proposed Governance Instrument, however, does not require that the issuer file a copy of any code of business conduct and ethics that the issuer may adopt and only requires that the issuer describe how a person or company may obtain a copy. Such an obstacle to disclosure for and access to stakeholders and investors of an issuer's code of conduct and ethical behaviour is a backward step and should not be implemented. An issuer should be required to file publicly any code of business conduct and ethics it may adopt and to disclose in its information circular how and where such a code may be accessed and viewed by the public.

4. **Proposed Governance Materials – Principle 6**

(a) The Commentary and Examples of practice to Principle 6 in the Proposed Governance Policy are generally adequate, but I suggest an amendment to the Examples of practice. I would also comment, however, that the disclosure concerning Principle 6 required in the Proposed Governance Instrument should be expanded because of the importance of disclosure to stakeholders and investors of significant conflicts of interests and transactions with control persons or significant shareholders (whether or not such transactions fall within the definition of 'related party transactions').

(b) With respect to Principle 6, Example of practices, General practices, sub-paragraph (a)(ii) of the Proposed Governance Policy, I suggest that control persons and significant shareholders be specifically referred to because of the importance of actual and potential conflicts of interest transactions with such persons and the heightened potential of conflicts with the interests of other stakeholders of controlled issuers. Actual and potential conflicts of interest with control persons and significant shareholders need to be managed as much as such conflicts with directors and executive officers. The amended sub-paragraph (a)(ii) would read:

(i) "reviewing and assessing situations, decisions, contracts, arrangements or transactions that could put directors, executive officers, <u>any affiliated entity, subsidiary entity or significant shareholder</u> in an actual or potential conflict of interest;"

(c) Proposed Form 58-101F requires disclosures with respect to practices involving significant conflicts of interest. I would suggest that paragraph (a) under Principle 6 be amended to be more specific and to require disclosure concerning the board's practices and practices related to actual or potential conflicts of interest with control persons and significant shareholders, as follows:

(i) "Describe any practices the issuer and the board use to identify, assess and resolve actual or potential significant conflicts of interest including with directors, executive officers, affiliated entities, subsidiary entities or significant shareholders;"

(d) Proposed Form 58-101F1 requires certain disclosures in connection with the appointment of an ad hoc committee to address a significant conflict of interest. I would suggest that it is important to stakeholders and investors that there is disclosure of the actions taken or recommendations made by the ad hoc committee that was appointed to address a significant conflict of interest and that paragraph (b) under Principle 6 be amended by adding sub-paragraph (iii) as follows:

(i) "state the actions taken or recommendations made by the ad hoc committee with respect to the significant conflict of interest that it was appointed to address."

(e) With respect to the disclosures concerning a consultant or advisor that has assisted a board or committee, it is important to disclose who selected and appointed the consultant or advisor. I suggest that sub-paragraph (c)(i) be amended to read as follows:

(i) "state the name of the consultant or advisor, the person who selected and retained the consultant or advisor and a summary of the mandate it has been given;"

5. **Proposed Audit Committee Materials and Proposed Approach to "Independence"**

One of the most critical aspects of the effectiveness of the corporate governance of reporting issuers for the benefit of all stakeholders, and particularly minority and non-controlling shareholders, is the independence of members of the board of directors. The board of directors approves the strategy of the company, appoints the CEO and has a responsibility to promote a culture of integrity and ethical behaviour in the conduct of the company's business. The board is accountable for its supervision of management in their joint stewardship of "other people's money". The principles by which the board considers a director to be independent or not, the criteria of independence and the disclosure and transparency of the results of the board's assessments of director independence are fundamental to enhanced shareholder and investor trust.

(a) Proposed Audit Committee Instrument, Section 1.4 Independence

(i) It would appear that the word "issuer" in paragraph 1.4(a) of the Proposed Audit Committee Instrument refers only to the reporting issuer itself as a separate corporate entity and does not include any subsidiary entity. It would appear logical, as a matter of policy, that a director who is an employee or executive officer of a subsidiary entity should be considered not independent. It would be difficult for a director who is an employee or

executive officer of a subsidiary entity to exercise independent judgment. I would suggest that paragraph 1.4(a) of the Proposed Audit Committee Instrument be amended as follows:

(A) "is not an employee or executive officer of the issuer or any subsidiary entity; and"

(ii) In my view, the proposed definition of independence in paragraph 1.4(b) does not clearly reflect the requirement that the board must exercise an objective or reasonable judgment, as opposed to its own subjective judgment, in applying the relevant criteria of independence to determine whether members of the board are independent. The concern that the board is to exercise its judgment objectively, and not subjectively, is a separate matter from the criteria of independence that the board is to apply in the exercise of its judgment. (The criteria of independence that the board is to apply in exercising its judgment is referred to in clause (iii) below.) With respect to how the board is to exercise its judgment on the required criteria, the phrase, "..., in the view of the issuer's board of directors having regard to all the circumstances,...", allows for an interpretation that the board is permitted to apply its own subjective opinion with respect to the criteria of independence, namely, whether a particular relationship with the issuer or management does or does not interfere with the exercise of a director's independent judgment. If a board is allowed to exercise its subjective judgment (i.e., to come to its own view) in interpreting the criteria of independence, it is quite likely that a subjective interpretation may result in a different conclusion than where the objective standard of a reasonable person is required to be used as the governing principle with which the board applies its judgment. The board should be required to come to an objective view of the criteria of independence, and not be permitted wide latitude within which it can make its own subjective interpretation of such criteria. As stated in the Request for Comments, "Ultimately determining independence is left to the reasonable judgment of the board of directors." As set out in clause (iv)(A) below, paragraph 1.4(b) should be revised to make sure that the board applies a "reasonable judgment", and not a subjective judgment. An example of the basis of the concern expressed in this clause is exhibited by the comments of the ASC in Appendix A of the Request for Comments. The ASC appears to oppose the removal in proposed paragraph 1.4(b) of what it considers "the [current] discretion of the board" to determine whether or not a director who is not an employee or executive officer is independent. The ASC also refers to the ability of the board to "subjectively and reasonably" come to a different conclusion concerning independence than a "reasonable person". Paragraph 1.4(b) should be amended to be clear that the board does not have a 'discretion', cannot apply a 'subjective' judgment and is required to apply the 'reasonable person' test to the criteria of independence.

(iii) In addition, with respect to the criteria of independence that the board is to interpret, the proposed change to the verb "perceived" from "expected" in paragraph 1.4(b) of the Proposed Audit Committee Instrument introduces (or, reintroduces) a number of ambiguous interpretative issues. The use of the verb "perceived" raises the question of 'perceived' by whom – anyone, and from what perspective? What is the 'eye of the beholder' or vantage point from which the board is to view this perception? Even though modified by 'reasonably', how is a board to formulate or define an overall 'reasonable perception' that the board is then to apply to the particular circumstances of each director – whose 'perception' is reasonable, as opposed to the perception that is unreasonable? A test of 'perception' creates a too subjective element and a too broad, uncertain and varying standard as a core element for board judgments on the important issue of director independence. Boards will not have the benefit of commonly accepted guidance for their analysis and there is no clear or established standard for boards to apply in interpreting a 'reasonably perceived' criteria of independence. As there is no common or accepted benchmark to be applied by boards to make judgments of what is 'reasonably perceived', shareholders and investors will not be able to equate or compare the results of the decisions of different boards on director independence because each board may well have a different view of how to interpret the 'reasonably perceived' criteria. Such a result would be a disservice to shareholders and investors who are entitled to assume and expect that boards are generally applying a common standard in determining the status of directors as independent or not independent. The uncertain criteria of 'perception' also ignores the important element of judging the probable future behavioural outcomes of the directors in question. How directors and boards actually act, or are reasonably expected to act, is what is important in determining independence, not how it might be perceived that they may act. A focus on the expected behaviour of directors is a more legally accepted and solid basis for analysis than a consideration of the perceived behaviour of directors. I would continue the more extensive interpretative experience that has been gained from the use of the verb "expected" which focuses a board's judgment on a 'reasonably expected' behavioural outcome, rather than introducing (or, reintroducing) the more uncertain and subjective test of a 'reasonably perceived' effect.

(A) Since 1978, the definitions of "material change" and "material fact" have used the test of "reasonably be expected" to determine certain important disclosure obligations for reporting issuers under provincial securities statutes. This standard has received judicial interpretation, is widely accepted and has been the subject of significant interpretative experience, including under the TSX timely disclosure policies and National Policy 51-201 Disclosure Standards.

(B) While the 1994 Toronto Stock Exchange Committee on Corporate Governance used the 'reasonably perceived' test for the definition of an 'unrelated director', this model was abandoned by the CSA in March 2004 when the newly promulgated NI 52-110 Audit Committees defined a 'material relationship' in subsection 1.4(2) as one that could "reasonably interfere with the exercise of a member's independent judgement"[3] Subsection 1.4(2) of NI 52-110 was shortly thereafter amended to define more accurately a 'material relationship' as one that could "be reasonably expected to interfere with the exercise of a member's independent judgement."[4] This is the current requirement.

(C) It is recommended that the 'reasonably expected' formula be retained.

(iv) I would suggest that the definition of independence in paragraph 1.4(b) be revised as follows :

(A) "does not have, or has not had, any relationship with the issuer or any subsidiary entity, or an executive officer of the issuer or any subsidiary entity, which could, in the reasonable opinion of the issuer's board of directors having regard to all the circumstances, be reasonably expected to interfere with the exercise of his or her independent judgment."

(v) The above revision to the proposed definition of independence would require the board of directors to exercise the objective judgment of a reasonable person (rather than its own subjective judgment) in interpreting the criteria of independence, which, in turn, is based on an accepted and objective standard of a 'reasonably expected' behaviour (rather than the broader but subjective test of a 'reasonably perceived' behaviour).

6. **Proposed Audit Committee Instrument, Part 3 Composition of the Audit Committee**

(a) As directors who are related to a control person or significant shareholders may be determined to be independent under the provisions of section 1.4 of the Proposed Audit Committee Instrument recommended by the CSA and would be permitted to be appointed to the audit committee, the audit committee may be composed entirely of directors who are, or who are related to, a control person or significant shareholder, as subsection 3.2(3) of the Proposed Audit Committee Instrument is drafted. Such a result is, in my opinion, neither appropriate on a public policy basis nor consistent with the interests of the other stakeholders of the issuer, including non-controlling shareholders who, particularly in dual-class voting share structures, may own a majority of the equity of the issuer. It appears

[3] (2004) 27 OSCB 3252 (March 26, 2004).
[4] (2005) 28 OSCB 3651 (April 15, 2005).

to me to be better public policy that at least a majority of the audit committee members be independent not only of management but also unrelated to a control person or significant shareholder. Consistent with this policy, I would also comment that it is reflective of accepted good governance principles that the chair of the audit committee not be, nor be related to, a control person or significant shareholder in order further to support the independence of this important committee for the benefit of the issuer's stakeholders and investors who rely on its financial statements. I would recommend that subsection 3.2(3) be amended to read:

(i) "Subject to sections 3.3 to 3.8, every audit committee member must be independent and a majority of the members of the audit committee, and the chair of the audit committee, must be unrelated to any affiliated entity or significant shareholder."

(b) Similar changes of principle should be made to paragraph 3.8(a) and paragraph 3.8(e) of the Proposed Audit Committee Instrument. Paragraph 3.8(a) should add the words at the end: "...or any subsidiary entity." Paragraph 3.8(e) should add the words at the end: "... and not related to any affiliated entity or significant shareholder."

7. **Proposed Audit Committee Instrument, Form 52-110F1**

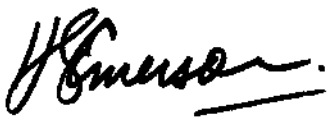
(a) I would suggest that section 2 of proposed Form 52-110F1 be amended to require disclosure of the name of the chair of the audit committee and whether he or she is independent or not independent and related or unrelated to any control person or significant shareholder.

8. **Proposed Audit Committee Policy, Section 2.4 Composition of the Audit Committee**

(a) Section 2.4 of the Proposed Audit Committee Policy endorses, as a policy matter consistent with how subsection 3.2(3) of the Proposed Audit Committee Instrument is proposed, the position of the CSA that the composition of an audit committee may be composed of at least a majority of independent directors who may be, or may be related to, a control person or significant shareholder. An "appropriate number" of independent directors on the audit committee who are unrelated to any control person or significant shareholder may be considered by a board of directors of a controlled issuer to be less than a majority of the audit committee members. As noted above, in my view, this is not the correct public policy result for the composition of audit committees of reporting issuers. If subsection 3.2(3) of the Proposed Audit Committee Instrument is not amended to require that the audit committee be composed of a majority of independent directors who are, and that the chair of the audit committee be an independent director who is, unrelated to a control person or significant shareholders, I would recommend that section 2.4 of the Proposed Audit Committee Policy be revised to read:

(i) "An audit committee should be composed of a majority of independent directors who are, and the chair of the audit committee should be an independent director who is, unrelated to any affiliated entity or significant shareholder."

Yours truly,



H. Garfield Emerson
Principal