Canadian Coalition for
GOOD GOVERNANCE

THE VOICE OF THE SHAREHOLDER

**VIA EMAIL**

April 20, 2009

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

***Attention:***

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
Fax: 514-864-6381
E-mail: consultation-en-cours@lautorite.qc.ca

John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, Ontario M5H 3S8
Fax: 416-593-8145
E-mail: jstevenson@osc.gov.on.ca

**Re: Request for Comment – Proposed Repeal and Replacement of NP 58-201 *Corporate Governance Guidelines*, NI58-101 *Disclosure of Corporate Governance Practices*, and NI 52-110 *Audit Committees* and Companion Policy 52-110CP *Audit Committees (the "CSA Release")***

We are pleased to provide you with the comments of the Canadian Coalition for Good Governance ("CCGG") on the proposed Corporate Governance Releases referenced above.

Representing the interests of institutional shareholders, CCGG promotes good governance practices in Canadian public companies and the improvement of the regulatory environment to best align the interests of boards and management with those of their shareholders, and to promote the efficiency and effectiveness of the Canadian capital markets. CCGG has over 40 members who collectively manage in excess of $1.1 Trillion of savings on behalf of most Canadians.

## GENERAL COMMENTS

### 1. Mandate Shareholder Democracy Provisions

The CSA should mandate that all public companies (including corporations, limited partnerships and trusts):

- Conduct all director or equivalent elections on a director by director basis (i.e. not on a slate basis)
- Have a majority voting policy that gives equity owners the effective ability to vote against a director or equivalent
- Separate the chair and CEO roles, with the chair being independent of management
- Have at least 2/3's of the board or equivalent "independent" of management

(the "Shareholder Democracy Provisions").

### 2. Adopt Proposed Definition of "Independence"

CCGG agrees that most directors should be independent of management, and not necessarily also be independent of a controlling shareholder. We recommend that the CSA adopt the proposed new definition of an independent director, subject to our detailed suggested modifications set out below.

### 3. Retain the Existing "Comply or Explain" Approach With Additions

While we agree that issues such as board orientation and assessment, codes of conduct, management of conflicts of interest, risk management, executive compensation and shareholder engagement are not suited to a prescriptive approach, we question why it is necessary to change the existing "comply or explain" approach and move to a "principles based" approach at this time. The existing disclosure regime could simply be supplemented by adding proposed Principles 6, 7 and 9.

Accordingly, we recommend that that the CSA leave NP 58-201 *Corporate Governance Guidelines* and NI 58-101 *Disclosure of Corporate Governance Practices* in place and supplement them with the content of proposed Principles 6, 7 and 9, which provide additional useful information for investors.

**Mandatory Shareholder Democracy**

We believe that the CSA should require all Canadian public companies (including corporations, limited partnerships and trusts) to implement the Shareholder Democracy Provisions, or the equivalent for their organizational form, rather than leaving adoption of these important shareholder rights to the discretion of the board.

CCGG has asked Canadian boards for nearly 6 years to voluntarily adopt the Shareholder Democracy Provisions, which have been CCGG Best Practices for some time and have been adopted by many leading boards in Canada. For example, over 115 TSX listed companies have adopted a version of our Majority Voting Policy.

However, the boards of many public issuers have paid little attention to these matters and, in some cases, have strenuously disagreed with our best practices.

As a result, CCGG believes that the Shareholder Democracy Provisions should be mandated by the CSA for all public companies, rather than leaving these important rights to the discretion of boards. Mandating a minimum level of shareholder democracy will not preclude companies from adopting additional shareholder rights such as better proxy access to shareholders.

*(Please also refer to the submission by CCGG to the CSA dated February 2, 2009 related to the mandating of a number of important shareholder democracy rights. It may be found at http://www.ccgg.ca/media/files/shareholder-democracy/Letter%20to%20CSA%20-%20February%202%2C%202009.pdf).*

**Market Efficiency Requires Standardized Shareholder Democracy Rights**

We believe that it would be more efficient for our capital markets to have minimum shareholder democracy standards so that:

- Investors – as providers of capital to companies - can assume that these rights exist in each company that they are considering investing in, providing easy comparability among companies
- Issuers will have “bright line” tests which are easier to adopt than vague “principles” and which their competitors for capital are also required to follow
- Canada will be at the forefront of shareholder democracy globally, which will increase transparency and board competency, lowering the cost of capital for all Canadian businesses.

Some may argue that adopting the Shareholder Democracy Provisions would be expensive for small issuers. However, we believe that these provisions can be implemented at no or very low cost, particularly if companies are given time to implement them. For example, implementing director by director voting and a majority voting policy could be done at no cost, and an independent chair and additional independent directors could be appointed over a reasonable period of time at minimal cost as a part of normal board transition.

If the CSA mandates the Shareholder Democracy Provisions for larger issuers only (so called "proportionate regulation"), it should be done in a manner that gives investors a simple way of identifying which companies are required to follow the Shareholder Democracy Provisions, and which companies have reduced governance expectations. One logical way to do this would be to require all TSX listed issuers to adopt the Shareholder Democracy Provisions, and to permit all other issuers (such as Venture Exchange issuers and other reporting issuers) to have a period of time to adopt them to reduce the economic cost of the transition.

Based on the foregoing, CCGG believes that there are strong market efficiency arguments for requiring all public companies to adopt the Shareholder Democracy Provisions.

------------------------------------------------------------------------------------------------------------------------

**SPECIFIC REQUESTS FOR COMMENT**

We have the following comments on your specific requests for comment:

1. ***Do you think Principles 6, 7 and 9 provide useful and appropriate guidance? Does this guidance appropriately supplement other corporate law and securities law (including legislation and decisions of Canadian courts) relating to these areas?***

   These principles do provide useful guidance – see our comments below on each. While there may be overlap with certain corporate laws, they essentially are a statement of the current statutory/fiduciary roles of directors.

   We note that the effective implementation of Principle 9 relating to shareholder engagement may require clarification of the rules relating to "selective disclosure", which have been cited in the US as a reason to restrict shareholder-board discussions. We understand that the Regulation fd in the US is sometimes cited by management who do not want their boards communicating with shareholders.

2. ***Does the level of detail in the commentary and examples of practices successfully provide guidance to issuers and assistance to investors without appearing to establish "best practices"?***

The commentary provides a sufficient level of detail for boards to understand how to implement the Principles in the context of their company. By their nature, many of the suggested ways to comply with the Principles are "best practices" and should be adopted by all issuers. We believe that the CSA can play an important role by identifying best practices for all issuers to strive towards.

3. ***In your view, what are the relative merits of a principles-based approach for disclosure, compared to a "comply or explain" model?***

   The current governance regime, referred to as "comply or explain", has the advantage of focusing the attention of boards on specific governance standards and requiring them to publicly state whether or not they have adopted each suggested provision. A "comply or explain" approach may also be less costly for smaller issuers than broad principles which will require external expert advice to understand and to develop strategies for compliance.

   We also note that the CSA in Staff Notice 58-303 observed that many companies do not comply with disclosure obligations unless the requirements are clearly described and are required.

   The CSA proposal appears to move away from the need for issuers to explain why they have not adopted the possible ways to implement each principle. As a result, under the Principles issuers may not be required to provide their thinking to shareholders on key governance matters, which is important information for shareholders.

4. ***Is the level of disclosure required under each of the principles appropriate both from an issuer's and an investor's point of view? Specifically, do you think the disclosure in respect of Principles 6, 7 and 9 provides useful information to investors?***

   The disclosure that Principles 6, 7 and 9 provides useful information to shareholders. The management of conflicts of interest and risks are important subjects that should be known by shareholders. As well, it is helpful that the Principles make it clear to boards and shareholders that board engagement with shareholders to understand the concerns of shareholders is a fundamental duty of directors.

5. ***Should venture issuers be subject to the same disclosure requirements concerning their corporate governance practices as non-venture issuers?***

   Yes, Venture Exchange issuers should be subject to the same disclosure requirements relating to their corporate governance practices, as all shareholders deserve to have the same level of disclosure on these important matters. While this disclosure may be lengthy for a large, complex company, the simpler business models of smaller companies should result in simpler and less costly governance disclosure.

6. ***In your view, what are the relative merits of the proposed approach to independence compared to the current approach? In particular:***
   a. ***Basing the determination of independence on perception rather than expectation; and***
   b. ***Guiding the board through indicia rather than imposing bright line tests?***

We agree in substance with the proposed definition, but note the following:

- A person will not be considered independent if he or she has had in the past a non-independent relationship with the issuer. Consideration should be given to adopting a "cooling off" process, such as not having had such a relationship for a number of years (say 3-5 years).

- We are content with the use of a "reasonable person" standard, but are cognizant of the point made by the ASC that it is not appropriate that "a reasonable but less informed and less experienced person's perception is the determining factor". To maintain the proposed objective standard while addressing the ASC's concern, we recommend that the relevant portion of the proposed definition be revised to read:

> "any relationship … which could, in the view of the issuer's board of directors having regard to all relevant circumstances, be perceived by a reasonable person, having the knowledge possessed by the board, to interfere with the exercise of his or her independent judgment".

Our proposed change assumes that the board will fully disclose the information that it used to make its determination of independence.

- One advantage of a bright line test is that it is possible for issuers to obtain legal opinions on compliance with the test. In any formulation based on a "reasonable person" standard, even assisted by regulatory guidance, it will likely be difficult for a board to obtain such an opinion. Accordingly, our proposed revision, above, attempts to strike a middle ground in which a board can nevertheless achieve a level of confidence that its conclusions, when reasonably reached based on due consideration of relevant facts, will not be held legally non-compliant after the fact based on a third party's "perception".

7. ***Is it sufficiently clear that the phrase "reasonably perceived" applies a reasonable person standard?***

   Please see our response to Question 6. We believe the notion of "perception" may usefully be replaced by specific adoption of a "reasonable person" standard, a concept with a developed legal meaning.

8. ***Is the guidance in the Proposed Audit Committee Policy sufficient to assist the board in making appropriate determinations of independence?***

   Yes, the proposed policy is sufficient, subject to our comments under Question 9, below.

9. ***The proposed definition provides that independence is independence from the issuer and its management, and not from a control person or significant shareholder. Given this definition:***
   a. ***Should a relationship with a control person or significant shareholder be specified in section 3.1 of the Proposed Audit Committee Policy as a relationship that could affect independence?***
   b. ***Should such a relationship be solely addressed through Principle 6 – Recognize and manage conflicts of interest as proposed?***
   c. ***Is it appropriate to include as an example of a corporate governance practice that an appropriate number of independent directors on a board of directors and audit committee be unrelated to a control person or significant shareholder?***

(a) No, a relationship with a control person or significant shareholder should not, in and of itself, be identified as a relationship that could affect independence. This is particularly the case where control is held through a controlling equity position (e.g. owning a majority of the common shares), as opposed to control held through multiple voting shares with minimal equity holdings (in which case the control relationship may lead to the interests of the controlling shareholder being significantly different than those of other shareholders). (See Policy Paper No. 3 of the Institute for Governance of Private and Public Organizations "*The Independence of Board Members" A Quest for Legitimacy"*, September 2008, for a full discussion of this issue).

The intent of the revised proposed definition of independence, as we understand it, is to recognize that, absent other distinguishing features, the interests of a control person or significant shareholder (and their representative on a board) are aligned with those of other shareholders. The re-insertion of such a relationship as an indicia in section 3.1 would create confusion and would be at odds with the intent of the revised definition.

We note that draft subsection 3.1(b) already raises this problem by referencing an employment relationship with "an affiliate of the issuer". The legal definition of "affiliate" includes not only entities controlled by an issuer, but also looks upstream to include a control person of an issuer. On its face, this would throw into question the independence of a representative of a control person who happens to be employed by that control person (and indeed, may be employed for the specific purpose of overseeing investments). We recommend that this subsection be revised to reference employment by a "subsidiary", rather than an "affiliate".

(b) Yes, we agree that issues in relation to a control person or significant shareholder are ones of self-dealing, and should be addressed under Principle 6 through a rigorous process for identification and management of conflicts of interest. This is particularly the case where control is held through multiple voting shares with minimal equity value, rather than through a controlling equity interest.

(c) As noted above, the issues relating to control persons and significant shareholders revolve around self-dealing and conflicts of interest. It would be appropriate to include as an example of a corporate governance practice that a board have a sufficient number of independent directors, who are also unrelated to a control person or significant shareholder, as are appropriate to discharge the board's responsibilities in relation to Principle 6. To refer to an "appropriate number", without further context, would beg the question of why any number is or is not appropriate, if an individual is otherwise "independent".

***10. Does the required disclosure on director independence provide useful and appropriate information to investors?***

We believe that this disclosure is important so that shareholders can judge the level of independence and relationships between directors and management.

We do not believe that disclosure of these relationships (or lack thereof) will impede the ability of a company to attract competent directors, as only potential directors with inappropriate relationships would object to such disclosure.

11. ***Do you think our proposal regarding the effective date adequately addresses the needs of both venture and non-venture issuers?***

    We suggest that the CSA use a year-end based implementation schedule to tie in with the annual meeting and proxy disclosure process. The implementation process used for the new executive compensation disclosure regime contained in NI 51-102 appears to have worked well and could serve as a model.

**ADDITIONAL COMMENTS**

On a careful reading of the Principles, it is possible for an issuer to interpret the Principles as suggested rather than mandated, which we do not believe to be the intention of the CSA.

A simple way to clarify the regulatory intention would be to use the word “shall” or “will” in the place of “should” in each Principle. For example, Principle 1 could be changed to read: “A [board] shall establish the respective roles and responsibilities of the board and the executive officers.”

------------------------------------------------------------------------------------------------------------------------

We have the following comments on each of the Principles:

**Principle One – Create a framework for oversight and accountability**

In many of the Principles, it is stated that it is either the “issuer’s” or the “board’s role to ….”. It should be clarified that it is the responsibility of the board to establish the roles of the board and the CEO - and not of the “issuer” (whoever that may be). This is a fundamental function of the board and not one that can or should be done by anyone else (for example, the CEO should not determine the role of the board).

We note, similarly, that the items set out under “Usual responsibilities of the board” are all clear duties of the board which cannot be delegated to management – and accordingly the word “usually” should be deleted. For example, risk management and succession planning are two of the key functions of every board and the CSA should not leave the impression that they can be delegated to the CEO.

**Principle Two – Structure the board to add value**

We agree that boards should be comprised of directors who will contribute to the effectiveness of the board. CCGG has prepared several documents to provide boards with guidance on ensuring that the board is effective, including our “Building High Performance Boards” (see www.ccgg.ca), as have organizations such as the Institute of Corporate Directors.

However, in addition to having the requisite skills, each director must have the confidence of a majority of the shareholders, which requires that there be functioning shareholder democracy at the issuer. The proposal suggests that boards consider a number of important shareholder democracy features, and that the board will decide if it wants to implement them. We do not believe this makes sense- the CSA should not leave these decisions to boards which have incentives not to implement them.

Accordingly, Principle Two should contain a requirement that each board:

- Adopt a majority voting policy similar in form to the CCGG model policy
- Have an independent chair, separate from the CEO
- Have at least 2/3's of the board independent from management
- Permit independent directors to regularly and on demand hold *in camera* sessions without management or other non-independent directors and to engage and pay external advisers at the expense of the issuer.

**Principle Three – Attract and retain effective directors**

We agree that a board should play an important role in selecting candidates for the board, and CCGG has recommended best practices for boards to follow in this regard (see "Building High Performance Boards" at www.ccgg.ca). The industry and company knowledge and experience of directors are very important to the long term success of the company, and should be important criteria in choosing directors. (We refer to the policy paper mentioned in our response to Question 9 for a more fulsome discussion of board competencies).

However, it should not be up to the board to determine who the board is ultimately comprised of, and boards should provide shareholders with the opportunity to vote for or effectively against each director ("Majority Voting").

We are concerned with the inclusion of the concept of retention of directors (which is only mentioned in the heading but not in the body of the Principle) as this may lead some boards to focus on director compensation retention based strategies which may create inappropriate incentives for directors.

We are also concerned with the suggestion that a board does not need to have a nominating committee comprised of independent directors – implying that is it acceptable to have management play a determinative role in board recruitment.

**Principle Four – Continuously strive to improve board performance**

CCGG has prepared a number of recommended practices for boards to improve their performance (see "Building High Performance Boards"), including requirements for comprehensive orientation, access to information and board assessments.

We also suggest that you include a reference to the significant value of formal director education (such as the programs offered by the Institute of Corporate Directors and The Directors College), and that companies should annually disclose the education and orientation activities of its directors in the year.

We note that access to executive officers and others throughout the company for directors should be a standard requirement and mandated.

**Principle Five – An issuer should actively promote ethical and responsible behaviour and decision-making**

We agree that ensuring ethical behaviour is a fundamental role for the board.

**Principle Six – Recognize and manage conflicts of interest**

We recognize that, while a board may be comprised of mostly truly independent directors, there are times when conflicts of interest may arise, for example between an issuer and its controlling or significant shareholder. As with Principle Five, the identification and management of conflicts is fundamentally a board responsibility, which should be recognized in the lead-in of the principle.

The interests of a controlling shareholder with little equity but multiple voting shares may not be aligned with those of the public shareholders. If so, the board should have directors who are also independent of the controlling shareholder who are focused on the conflicts of interest created by the differing interests of the controlling shareholder and the equity owners.

**Principle Seven – Recognize and Manage Risk**

Risk management is a fundamental role of a board which should be made clear by changing the second section of the Principle to read: "The *board* shall establish a sound framework of risk oversight and management". As well, the last sentence of the Commentary should delete the word "usually" as risk management is always a core duty of the board.

**Principle Eight – Compensate Appropriately**

Determining executive compensation is also a core duty of the board which should be made clear by changing the second part of the Principle to "the *board* shall ensure that compensation policies align with the best interests of the issuer".

While compensation is a complex process for a board, we agree that a principles based approach is suitable for executive compensation, and we note that CCGG has released for comment its "Principles of Executive Compensation" for use by boards as guidance from their shareholders (see www.ccgg.ca).

CCGC believes that every issuer should have an executive compensation committee comprised of directors independent of management, as management should not determine its own compensation.

**Principle Nine – Engage effectively with shareholders**

We agree that the board should be informed of the views of its shareholders through the annual meeting process as well as through ongoing dialogue (known as "shareholder engagement").

In addition to the cited examples of best practices, we would recommend the following be added:

- The board should clearly understand that it has a duty to engage its shareholders in a two way dialogue on a regular basis
- The board should adopt policies to ensure that it provides shareholders with opportunities to engage (for example at the AGM) and that management does not unreasonably or inappropriately insulate directors from shareholders.

We noted in our February 2009 submission to the CSA that there are fundamental problems with the voting process in Canada (some of which are beyond the control of individual companies) that the CSA must address through enforcement of existing laws and perhaps new provisions.

---

We would be pleased to discuss our comments on more detail with you at any time.  If you would like to do so, please contact our Executive Director, Stephen Griggs, at 416 868 3585 or sgriggs@ccgg.ca.

Yours truly,

Doug Pearce
Chair
Canadian Coalition for Good Governance