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Corporate Secretary
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Mr. John Stevenson
Secretary
Ontario Securities Commission
Suite 1900
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Dear Sirs/Mesdames:

Re: Proposed National Instrument 58-101 *Disclosure of Corporate Governance Practices* ("NI 58-101"), National Policy 58-201 *Corporate Governance Principles* ("NP 58-201"), National Instrument 52-110 *Audit Committees* ("NI 52-110") and Companion Policy 52-110CP *Audit Committees* ("CP 52-110")

Thank you for the opportunity to provide comments on the above noted materials, which were published for comment in December 2008. As you will note we have provided comments on a few aspects of the published materials rather than provide responses to all of your specific questions. However, we have specifically addressed the questions posed by the Alberta Securities Commission ("**ASC**") in Appendix A to the Report for Comment.

In our Public Markets practice, we act for a significant number of participants in the Canadian capital markets including public issuers that are required to apply the existing corporate governance rules in general and the audit committee rules in particular to their circumstances. While the reforms proposed by Canadian Securities Administrators ("CSA") are of significant interest to our capital markets clients and many of them have asked us for guidance as to the proposed new approach and have provided us with feedback, this comment letter is not written on behalf of any particular client or group of clients and the views expressed herein are those of the Bennett Jones lawyers and counsel who have participated in the preparation of this letter.

1. *Overall Comment*

While we welcome clarification of the treatment of controlled companies, we are surprised by the nature and scope of all of the proposed changes, especially in the absence of any identified and unsolvable problems with the current Canadian corporate governance regime. In particular, we view with skepticism the proposed adoption of a principles-based approach modeled on regimes in Australia and the U.K. because of the very different corporate and securities regulatory regimes and domestic capital markets in those countries. Rather than substituting Australian/U.K. approaches for the U.S.-inspired current Canadian regime, CSA might be better advised to conduct a more

fundamental study of the adequacy of the current Canadian approach to corporate governance and what type of corporate governance regime makes the most sense for the Canadian capital markets in light of its various unique characteristics (including the relatively small size of the Canadian capital markets; the relatively large number of small issuers; the large number of issuers inter-listed in the U.S.; the large number of controlled companies; our distinct regional capital markets; and the few key industries which are represented by public issuers).

For example, since the United States Congress adopted the *Sarbanes-Oxley Act of 2002*, considerable empirical research has been conducted in the United States and other countries which casts significant doubt on the economic value of director independence as opposed to specific skills held by individual directors.[1] Other empirical research in Canada and elsewhere has established the superior economic performance of controlled public companies – in particular, family-controlled public companies – compared to widely-held public companies.[2] We suggest that such a "first fundamentals" study should be conducted before CSA makes a regime change on the scale of that contemplated. We also believe that in the absence of any urgency, CSA could benefit from a more inclusive consultation process before publication of a comprehensive, new regime.

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1 For a review of various studies, see Roberta Romano, "SOX and the Making of Quack Corporate Governance" (2005) 114 Yale L. J. 1521 at 1533 where she notes (regarding the composition of audit committees in particular) that the "compelling thrust of the literature ... does not support the proposition that requiring audit committees to consist solely of independent directors will reduce the probability of financial statement wrongdoing or otherwise improve corporate performance." See also Sanjai Bhagat & Bernard Black, "The Non-Correlation between Board Independence and Long-Term Firm Performance" (2002) 27 J. Corp. L. 231. The authors concluded that firms with more independent boards did not perform better than other firms and noted that there were hints in their data that they perform worse than other firms; and April Klein, "Firm Performance and Board Committee Structure" (1998) 41 J. L. & Econ. 275. Klein found little evidence that the "monitoring" committees of a board which are usually dominated by independent directors – audit, compensation and nominating – affect firm performance, regardless of how they are staffed. However, Klein found a positive relation between the percentage of inside directors on board finance and investment committees, and accounting and stock market performance measures. These two board committees were selected because they are generally charged with reviewing long-term corporate strategy, financial policies and investments – mandates which favor a director with a sophisticated understanding of the corporation's business. The suggested reason for this positive relationship is that boards need specialized, expert-provided information regarding the firm's activities to evaluate and ratify the firm's long-term strategies. Outside directors often lack both the time and firm-specific expertise to provide this insight.

2 For example, see Benjamin Maury, "Family Ownership and Firm Performance: Empirical Evidence from Western European Corporations" (2006) 12 J. Corp. Fin. 321 at 322; Ronald C. Anderson & David M. Reeb, "Founding-Family Ownership, Corporate Diversification and Firm Leverage" (2003) 46 J. L. & Econ. 653; Peter Klein, Daniel Shapiro & Jeffrey Young, "Corporate Governance, Family Ownership and Firm Value: the Canadian Evidence" (2005) 13 Corporate Governance 769 at 770; and The Institute for Governance of Public and Private Organizations, "Dual-Class Share Structures in Canada: Review and Recommendations" (October 2006).

2. *Proposed Definition of "Independence"*

We have a number of concerns about the proposed new definition of "independence" in NI 52-110 which has the effect of broadening the circumstances in which a director could be considered not to be independent:

First, we note that the concept of "perception" in the new definition is much broader and more subjective than that of "expectation" in the current definition. "Perception" is a relatively nebulous concept and we question its appropriateness in the corporate governance context. Should perception or reality be the governing factor when assessing a director's independence?

Second, we note that, unlike the definition of independence found in the ASX *Corporate Governance Principles and Recommendations*, the proposed new CSA definition lacks the concept of materiality. Although CP 52-110 states in Section 3.1 that the board should apply appropriate materiality thresholds when assessing independence, we believe that the concept of materiality should be imbedded in the definition of independence itself.

Third, the proposed definition suggests that an individual could never become independent if he or she *previously had* a relationship that could be reasonably perceived to interfere with his/her independence, *even if* that relationship had ended. In current NI 52-110, certain bright line-tests are limited to a three year "look back" period.

Fourth, we share the concern of the ASC that clause (b) of the proposed definition may remove the discretion of the board of directors to determine whether or not a director who is not an employee or executive officer is independent. We do not believe that the "reasonable person" test should apply in the determination of the independence of a director. We believe that the judgment of the board of directors – and not some less informed third party – should apply in determining the independence of any individual because the directors are in the best position to make an informed decision based on all relevant facts, circumstances and board experience.

3. *New Disclosure Requirements*

We share the concern of the ASC concerning the requirement in proposed Form 58-101F1 that issuers explain why a director has been found to be independent if a relationship enumerated in Section 3.1 of proposed CP 52-110 exists. In our view, no meaningful purpose is served by the disclosure of the details of arrangements and relationships which are found by the board to be neither material nor relevant. To the contrary, disclosure of such information could raise privacy or confidentiality concerns and encourage "second guessing" by less-informed third parties. We agree with the ASC's concern that the mandating of such intrusive disclosure could lead to some qualified persons not becoming directors.

4. *Controlled Companies*

We agree with CSA's clarification that independence means independence from the issuer and its management. However, we note that CSA also states that a factor to consider when assessing independence is a control person's or significant shareholder's "involvement with the management of the issuer" [Section 3.1(c) of CP 52-110]. In our view, the concept of "involvement with management" is overly broad and has the potential of disqualifying those control persons or

significant shareholders who are neither employees nor executive officers of an issuer. We believe that service as an employee or executive office should be the governing factor rather than an uncertain concept of "involvement with management."

With respect to Questions 9(a), (b) and (c), we do not believe that a relationship with a controlled person or significant shareholder should be specified in Section 3.1 of proposed CP 52-110 as a relationship that could affect independence. Instead, such a relationship should be solely addressed through Principle 6 (Recognize and manage conflicts of interest) of NP 58-201.

Similarly, we do not agree with the suggestion 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. Connection to a significant shareholder should not, alone, be sufficient to make a director not independent.

5. ***ASC Specific Requests for Comment***

(a) For the reasons discussed in section 2 above, we agree that the board should subjectively determine whether or not a director is independent and require that the board's subjective determination be reasonable rather than utilizing the "reasonable person" test.

(b) For the reasons discussed in section 4 above, we feel that it is inappropriate and unnecessary to include being actively involved in the management of the issuer as one of the relationships that could affect independence enumerated in Section 3.1 of proposed CP 52-110.

(c) For the reasons discussed above, we:

(i) do not feel that it is appropriate to require that the board provide a detailed explanation as to <u>why</u> a director was found to be independent;

(ii) agree that requiring such an explanation could create a presumption that each relationship enumerated in Section 3.1 of the Proposed Audit Committee Policy affects the exercise of independent judgment unless the contrary is proven;

(iii) feel that it is preferable that the disclosure requirements oblige an issuer to provide the board's conclusion with respect to any director whom the board determines is independent <u>without</u> requiring a detailed explanation of the relationships considered; and

(iv) do not think that the requirement that the issuer identify the remaining directors as "not independent" might result in the perception that such an individual cannot exercise independent judgment and, as such, affect that individual's willingness to serve as a director.

Please note that the following members of our Public Markets Group have participated in the preparation of this letter and may be contacted directly in the event you have any questions concerning our submissions:

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Yours truly,

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