H. GARFIELD EMERSON

February 8, 2011

To:

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission – Securities Division
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
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

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Proposed Amendments to Form 51-102F6 *Statement of Executive Compensation* and Consequential Amendments

I am writing in response to your Notice and Request for Comments with respect to the Proposed Amendments to Form 51-102F6 *Statement of Executive Compensation* and Consequential

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Amendments. (For the purpose of this comment letter and ease of reference, the text of Appendix B – Blackline of Form 51-102F6 to the Notice and Request for Comments is referred to as the "**Proposed Amendments**").

This comment letter responds to only certain selective issues in the Proposed Amendments and does not cover all of the issues and questions raised in the Notice and Request for Comments.

The basic thrust of the comments in this letter and related recommendations relate to enhanced disclosure of important governance issues regarding the compensation committee and to increased transparency of certain key policies and practices of the compensation committee.

Section 2.1 – Compensation Discussion and Analysis – Commentary

Item 3 of the Commentary following section 2.1(5) of the Proposed Amendments provides examples of matters that will usually be significant elements of disclosure concerning compensation in response to the disclosure requirements of section 2.1 – Compensation Discussion and Analysis. They are "examples" that "will usually be significant", but are not items in respect of which disclosure is mandated for the benefit of stakeholders and investors.

Certain "examples" contained in bullets under item 3 of the Commentary following section 2.1(5) of the Proposed Amendments which raise particularly important disclosure matters concerning compensation policies and practices are the following:

- "policies and decisions about the adjustment or recovery of awards, earnings, payments, or payables if the performance goal or similar condition on which they are based are restated or adjusted to reduce the award, earning, payment, or payable;"

- "any waiver or change to any specified performance goal of similar condition to payout for any amount, including whether the waiver or change applied to one or more specified NEOs or to all

compensation subject to the performance goal or similar condition;"

- "whether the board of directors can exercise a discretion either to award compensation absent attainment of the relevant performance goal or similar condition or to reduce or increase the size of any award or payout, including if they exercised discretion and whether it applied to one or more named executive officers;"

The subject matter of the first bullet quoted above is related to the topic that may be referred to as 'executive compensation clawbacks'. It may fairly be said that the topic of executive compensation clawbacks is not unrelated to the issue introduced in section 2.1(5) of the Proposed Amendments, namely, the consideration of the risks associated with the company's compensation policies and practices. Nor are executive compensation clawbacks programs new or novel as they have been features of executive employment agreements for some time, particularly with respect to recovering severance payments and post-employment benefits and entitlements where the executive violates non-competition, non-solicitation or confidentiality obligations.

In 2002, the enactment of the *Sarbanes-Oxley Act* in the United States contained a clawback provision which imposes severe financial penalties on the CEOs and CFOs if the financial statements issued by their companies are determined to have been materially inaccurate. Section 304 of SOX provides that if an issuer is required to prepare an accounting restatement "as a result of misconduct", the CEO and CFO (but not any other officer or employee) shall reimburse the company by disgorging any bonus or incentive or equity-based compensation received and any profits realized from the sale of company stock during the 12 month period following the filing of the financial statements that require restatement. Only the SEC can enforce these provisions.

In addition to the enforcement tool provided to the SEC by SOX, according to research undertaken by The Corporate Library, by July 2008 more than 34% of the S&P 500 companies had themselves adopted clawback policies relating to recouping incentive compensation in connection with fraud-based and

performance–based provisions, although such clawback rights have been predominantly adopted by larger S&P 500-type companies rather than smaller firms. According to a Shearman & Sterling LLP survey of corporate governance practices of the largest 100 companies in the United States, 56 companies disclosed that they had clawback policies in 2009, up from 35 in 2007.

The *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010* of the United States created a new section 10D of the United States *Exchange Act* which requires listed public companies to develop and implement policies to recapture – or clawback – compensation "erroneously awarded" to executives prior to the restatement of the company's financial statements. According to an analysis by Cravath, Swaine & Moore LLP, this requirement is mandatory, covers all present and former executive officers and does not require misconduct by the company or any officer as a condition for the issuer to invoking the clawback. The *Dodd-Frank Act* does not give the SEC or the exchanges the authority to exempt smaller issuers, foreign private issuers or controlled companies from the clawback requirements.

Canadian legislation and securities law has not proceeded down the path of addressing executive clawback provisions based on the filing of materially inaccurate financial statements that required restatement. It is not that there have not been in Canada examples of the filing of financial statements that were misleading and required restatement. In October 2003, the audit committee of Nortel Networks Corporation commenced an investigation of the issues leading to the first of several restatements of Nortel's previously filed financial statements. Based on periodic reports on the progress of an investigation by an independent law firm and expert accountants, the Nortel board terminated for cause in April 2004 the CEO, the CFO and the Controller and, in August 2004, seven additional senior finance employees of the company, because it held them responsible.

It is recommended that the first bulleted example of a usually significant element of disclosure quoted above regarding executive clawback provisions be elevated into a disclosure requirement to advise stakeholders and investors whether the

company has adopted executive clawback provisions, the material terms of any such policy and any proceedings initiated under the policies. A new section 2.1(6), after the currently proposed section 2.1(5), may be added to the Proposed Amendments as follows:

"Disclose whether the board of directors has adopted policies concerning the adjustment or recovery of awards, incentive-based compensation (including stock options and equity-linked and other entitlements), earnings, payments, or payables (including post-employment benefits), from the company's executive officers either in the event that the performance goal or similar condition on which they are based are restated or adjusted to reduce the award, compensation, earning, payment or payable, or the company restates a previously filed financial statement due to the material non-compliance of the company with any financial reporting requirement, describe the scope and terms of any such policies, and any decisions or proceedings that the company may have made or initiated under such policies."

The second and third bullets quoted above deal with different compensation issues and are related to the board of directors and the compensation committee's decision-making processes.

Whether a board of directors or the compensation committee is authorized to and does in fact exercise discretion in awarding compensation where the relevant objective or quantitative performance goals or other conditions relating to the earning or granting of compensation awards have not been satisfied are most important components of understanding the practices, processes and behaviour of the compensation committee, and how the board and the committee implement the company's compensation policies. Disclosure of the extent to which compensation awards are linked to corporate performance and the attainment of objective and measurable performance goals, and disclosure of the company's actual decision-making processes for determining compensation, particularly in relation to performance, are key factors for the company's stakeholders and investors to understand.

It is material information for investors to know the actual behaviour of the board of directors and the compensation committee in relation to the objectives that are set by the board or the compensation committee to align compensation with performance. Securityholders should be provided with information with respect to the extent, if any, that the board of directors or the compensation committee exercises discretion to award compensation where performance goals have not been met, or waives or changes performance goals to payout, or increases compensation beyond the previously approved levels, referred to as 'upward discretion'.

Such disclosure will provide information to investors with respect to the actual linkage of compensation to performance and the appropriateness of the measurable performance goals that were established and with respect to whether the 'at risk' pay-for-performance remuneration of the NEOs in fact varies significantly with corporate results.

It is therefore recommended that the above matters in the last two bullets quoted above be changed from "examples of items that will usually be significant elements of disclosure" to being required subjects of disclosure concerning compensation to the extent that they in fact take place.

It is recommended that it is appropriate to add a new subsection 5 to section 2.1 (inserted after section 2.1(4), which discusses performance goals, and before the current section 2.1(5), which deals with relating risk to compensation policies) to require disclosure whether the board of directors or the compensation committee has such discretionary authority, and any exercise of such discretion, and whether there has been any waiver or change of performance goals. A new section requiring such disclosure is suggested as follows:

"Disclose whether the board of directors or the compensation committee

(a) waived or changed any specified performance goal or similar condition to payout for any amount, and, if so, whether the waiver or change applied to one or more specified NEOs or

to all compensation subject to the performance goal or condition, specifying those officers to whom any such waiver or change applied; and

(b) can exercise a discretion, either to award compensation absent attainment of the relevant or applicable performance goal or similar condition or to reduce or increase the size or value of any award or payout, and, if the board of directors or the compensation committee exercised such discretion, whether it applied to one or more NEOs, specifying those officers to whom the exercise of such discretion applied."

Section 2.4(2) Compensation Governance

Section 2.4(2)(a) of the Proposed Amendments only requires disclosure of the names of each member of the compensation committee and a statement "whether or not the committee is composed entirely of independent directors." For the purposes of section 2.4, the Commentary to that section provides that a director is considered "independent" if he or she would be independent within the meaning of section 1.4 of NI 52-110 *Audit Committees.*

There is no requirement that either a majority or all of the members of the compensation committee be "independent directors". The requirement that all members of a committee be "independent directors" is only applicable to the audit committee of a reporting issuer [NI 52-110 *Audit Committees*]. Section 3.15 of NP 58-201 *Corporate Governance Guidelines* which states that the board "should appoint a compensation committee composed entirely of independent directors" is a guideline only and is not mandatory.

In view of the importance of the composition of compensation committees of reporting issuers, it is recommended that the disclosure required by section 2.4(2)(a) of the Proposed Amendments be amended to provide not only the name of each committee member but also to disclose, in respect of each member, whether or not the member of the compensation committee is independent or is not independent. The current provision only requires a statement whether "the committee is composed entirely of independent directors", and does not require

disclosure concerning the independence of each member of the compensation committee.

There will not be any unnecessary redundancy in requiring disclosure whether each member of the compensation committee is independent or is not independent. While the disclosure requirement in section 1(a) of Form 58-101F1 *Corporate Governance Disclosure* to NI 58-101 *Disclosure of Corporate Governance Practices* does require disclosure of the identity of directors who are independent, such disclosure is only required in connection with proxy solicitations for the purpose of electing directors: section 2.1(1) of NI 58-101 *Disclosure of Corporate Governance Practices*. Form 51-102F6 *Statement of Executive Compensation* disclosures may, however, be required in connection with proxy solicitations other than in connection with electing directors, i.e., where securityholders are asked to vote on matters relating to executive compensation, including "say-on-pay' advisory votes. In addition, the justifiable disclosure whether each member of the compensation committee is an independent director or not should be easily available to investors without requiring them to cross-reference to other parts of a lengthy management proxy circular by providing such information directly under the section 2.4 Compensation Governance disclosures that contains related information of other important matters concerning members of the compensation committee, such as the compensation committee members' experiences, skills and abilities.

It is further recommended that section 2.4(2) of the Proposed Amendments be amended to provide the following disclosures in respect of the members of the compensation committee, in addition to stating whether each member is independent or not independent:

(a) "State the names of the members of the compensation committee considered by the board of directors to be independent, with the following information for each of those directors, if any:

> **(i) a description of any relationship with the issuer or its affiliated or subsidiary entities, with a significant**

shareholder of the issuer or with any of the executive officers of the issuer that the board of directors considered in determining the director's independence; and

(ii) if the director has a relationship referred to in sub-paragraph (i), a discussion of why the board of directors considers the director to be independent.

(b) State the names of the members of the compensation committee considered by the board of directors to be not independent and describe the basis for that determination."

Recommended clause (a) above is based in part on a portion of the draft materials in Request for Comments – 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 52-100CP *Audit Committees*, (2008) 31 OSCB 12158 (December 19, 2008). See draft Form 58-101F1 *Corporate Governance Statement*, Principle 2, clause (d).

Recommended clause (b) above is similar to the disclosure currently required in section 1(b) of Form 58-101F1 *Corporate Governance Disclosure* for proxy solicitations in connection with the election of directors for directors who are not independent.

Section 2.4(3) Compensation Governance

Section 2.4(3) of the Proposed Amendments requires certain disclosures to be made with respect to compensation consultants or advisors who have been retained to assist the board of directors or the compensation committee in determining compensation for any of the company's directors or executive officers. .

Section 2.4(3)(c) is unclear, and limited, with respect to disclosure of services that may be provided by the consultant or its affiliates in addition to or other than with respect to advising on director or executive officer compensation. Section 2.4(3)(c) requests disclosure if the consultant or advisor or any of its affiliates "has provided any other non-executive compensation services for the

company." [underline added] It is submitted that such disclosure should not be restricted to "other non-executive compensation services" Consultants or their affiliates may, among other services, also provide to the company, or its affiliated or subsidiary entities, general human resource development and training services, management succession planning, benchmarking and assessments, identifying and recruiting new employees, industry management remuneration data, advice on pension management and benefits, and actuarial services.

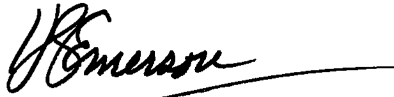
It is recommended that section 2.4(3)(c) be amended to make it clear that disclosure is required if the consultant or advisor or any of its affiliates

"has provided any services for the company, any of its affiliated or subsidiary entities, or any of its directors or member of management other than or in addition to compensation services for any of the company's directors or executive officers".

Such a change would make it clear that disclosure of other services provided by the consultant or advisor is required where such other services are provided to the company, or any of its affiliates or subsidiaries, or to any director or member of management other than in respect of compensation services for any of the directors or executive officers of the company..

The change is also consistent with section 2.4(3)(c)(ii) of the Proposed Amendments, which refers to "other services" and is not limited to "non-executive compensation services" as currently provided in subclause (c), and consistent with section 2.4(3)(d)(ii), which requires fee disclosure "for all other services provided by the consultant or advisor, or any of its affiliates, ...".

Yours very truly,



H. Garfield Emerson, Q.C.