EMERSON ADVISORY
333 BAY STREET, SUITE 2400
BAY ADELAIDE CENTRE, BOX 20
TORONTO, ONTARIO, CANADA M5H 2T6

H. GARFIELD EMERSON
PRINCIPAL

DIRECT 416 865 4350
FAX 416 364 7813
gemerson@emersonadvisory.com

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Ontario Securities Commission
20 Queen Street West, Suite 1903
Toronto, Ontario M5H 3S8

Attention : The Secretary

OSC Staff Notice 15-704: Proposed Enforcement Initiatives

The No-Contest Settlement Program

Dear Sirs:

Thank you for the opportunity to comment on OSC Staff Notice 15-704 – *Request for Comments on Proposed Enforcement Initiatives* (the "Proposals").

This letter responds only to the issues raised in the Proposals, prepared by staff of the Ontario Securities Commission ("OSC"), related to the No-Contest Settlement program.

It is encouraging that the current OSC leadership and staff commenced active discussions to finalize proposed policies and procedures that will enable the OSC to advance to more vigorous and effective regulatory enforcement practices, hopefully buttressed with necessary increases in resources to support the important initiatives of the OSC in this regard. These important new movements forward will hopefully spark improvements in protections for investors and in building increased trust and confidence in stronger, fairer and more efficient capital markets in Ontario.

It is appropriate for the OSC to adopt new methods and instruments to improve and make more efficient its enforcement activities, as well a adding resources to its enforcement branch. The issue is only tailoring the policies, standards and procedures of a No-Contest Settlement program after addressing public matters appropriately.

As investor protection is a core part of the OSC's legislated mandate, the adoption of No-Contest Settlements must be considered in the broadest context. While resolving enforcement matters "more quickly and effectively" and creating a "higher volume of protective orders" are worthy public interest objectives, there are several other important public interest matters that should be noted and addressed in the discussion to consider introducing No-Contest Settlements.

An adoption of a No-Contest Settlement program should also be guided by the principle that the exercise of the OSC's 'public interest' jurisdiction under section 127 should be administered in a publicly transparent manner and process, based on principles and standards that are publicly enunciated. It would not be appropriate for a public agency to make decisions regarding No-Contest Settlement enforcements in non-public forums or based on evidence adduced in confidential conferences or in camera hearings. The integrity of the administration of the purposes of the *Securities Act* in section 1.1 requires public processes and open disclosures.

Some summary overriding thoughts:

- In approving No-Contest Settlements, should there not be additional enunciated standards that the agreements must satisfy beyond "in the public interest", such as being fair, reasonable and adequate in the circumstances of the case?

- Should No-Contest Settlements be approved where there is a reasonable expectation that the terms of the settlement would negatively affect the private rights of investors and stakeholders who have suffered loss from the conduct in question to seek redress for damages in civil actions?

- Is it appropriate that No-Contest Settlements be investigated, prosecuted, negotiated and approved within the same multi-functional integrated agency which has many different and overlapping roles? Is there an effective mechanism for oversight and accountability of the OSC in agreeing and approving No-Contest Settlements?

- Should No-Contest Settlements agreed by OSC staff with settling respondents be approved by an independent administrative authority?

- Is there transparency and openness in the OSC's policies, processes and procedures concerning the administration of No-Contest Settlements?

The Proposed No-Contest Settlement Program

Some Underlying Principles

The resolution of enforcement actions initiated by the OSC, by means of negotiated settlements where they are able to be resolved on terms, which in relation to the circumstances, are fair, reasonable and adequate, and in the public interest. It is not a necessary ingredient in satisfying the public interest that all quasi-criminal or administrative enforcement actions need to be resolved through full adversarial procedural hearings. The public interest, investor protection

and the promotion of fair and efficient capital markets may be well served where, in the right circumstances, the OSC reaches appropriate settlements with alleged wrongdoers on fair, reasonable and adequate terms.

There is also a valid position that a policy objective of reaching negotiated settlements in all enforcement actions on fairly standard terms with boilerplate language is not 'in the public interest'. The public interest will not be served if the OSC settles an enforcement action where the terms and conditions of the settlement are not fair, reasonable and adequate in relation to the circumstances of that case. There should be no obligation on the OSC to settle any enforcement action, and increased prudence is appropriate especially in circumstances where the respondent neither "admits nor denies" the facts of the alleged wrongdoing. Of course, there may be those enforcement actions where the facts of the alleged wrongdoing are not easily able to be proven in formal proceedings by the OSC, the facts and circumstance of the alleged wrongdoing are neither wilful nor the cause of loss and damage to others, or other relevant mitigating factors are present that lean towards No-Contest Settlements.

There are no 'bright line' tests to be applied in order to reach decisions that are 'in the public interest', based on a pre-established formula, or an OSC articulated policy, which is to be applied to any and all set of facts.

It is useful to consider that the introduction of any dramatic and material changes to established and long-standing policies and procedures regarding the administration, enforcement and prosecution of alleged violations of Ontario securities law should only be made after a careful review of all relevant factors, with caution and with the reasonable assurance that the implementation of substantial changes will not have unintended consequences and that fulfilling the statutory mandate of the OSC to provide investor protection and foster fair and efficient capital markets will not be adversely affected.

In considering the merits of the OSC staff proposal for No-Contest Settlements, it should not be overlooked that the Proposal may be argued by some, fundamentally stated, to serve in large measure the immediate law enforcement interests of the OSC, in contrast to also accommodating the broader (societal) 'public interest'. The No-Contest Settlement Proposal, as the OSC staff admits, would, in the view of the OSC staff, remove a number of procedural obstacles to and expedite their investigative work, remove certain negative impacts on respondents agreeing on settlement matters on a timely basis, accelerate more settlements sooner, provide more so-called protective orders, and expand resources for other and more enforcement actions. These efficiency prosecutionial benefits, while certainly related to and part of the broader public interest, should not be considered by themselves or in the aggregate to be a sufficient rationale for the adoption of the No-Contest Settlement. There may be various other ways to address some of these operational problems that are properly raised by OSC staff. These may include the expansion and dedication of needed additional resources to the enforcement branch and staff, a review of the adequacy of the OSC's existing investigation and examination powers and rights, and whether they are being utilized to their full authority, and, if required, the development of new investigative powers and subpoena and summons rights for the OSC which would entitle it quickly to obtain, under appropriate conditions, relevant documents and facts, whether or not 'interested persons' refuse to cooperate on a timely basis. The enforcement branch should have the necessary resources and authorities to pursue their recognized proper

purposes, and their legitimate activities should not be diluted, by reason of the lack of available powers and resources. This not to say that No-Contest Settlements are not appropriate. A reduced or frustrated level of enforcement services, however, should not be compensated for solely by adopting compliance policies if they are designed with a primary purpose to make it easier to reach settlements with alleged wrongdoers, especially "without admitting or denying" any misconduct.

A further point to put on the table for discussion is that Ontario should not adopt SEC enforcement practices because they have and continue to be used and espoused by the SEC to encourage settlements.. The grass in the other field is not always greener. Foreign securities enforcement policies may not be applicable in or appropriate for the Ontario environment and its culture. The legal, law enforcement and judicial systems in the United States are quite different from those developed by our Canadian heritage and current governmental and jurisdictional structures. In addition, while the policy of the SEC to settle enforcement actions "without admitting or denying" the facts in the statement of complaint of alleged wrongdoing has been in place since the early 1970s, there is currently not unanimity in the United States endorsing the continuance of that SEC policy. There are significant voices in the United States questioning the manner in which it is being applied by the SEC. The position of Judge Rakoff in the SEC's no fault case against Citigroup Global Markets, noted below, is a current public example of problematic aspects that can flow out of a policy of No-Contest Settlements.

The final point of principle to insert into the debate in the discussion whether the adoption of a No-Contest Settlement program is right for Ontario is to recognize that the plaintiffs' bar, acting for allegedly injured shareholders and stakeholders, including in class action lawsuits, seeking to recover damages for investor and shareholder losses, appear not to be in favour of a No-Contest Settlement policy, By contrast, legal defense counsel who represent corporations, directors and management against OSC enforcement proceedings and securities law litigation from stakeholders are much in favour of changing the current OSC policy and practice of requiring respondents in OSC enforcement settlement actions to admit and agree to a statement of facts. If there is a change so that the respondents in an OSC enforcement action do not have to admit the facts related to alleged wrongdoing in a settlement with the OSC, the plaintiffs in a civil action would suffer and the defendants who settled with the OSC would benefit, because there would be no admission of facts associated with the alleged wrongdoing in the OSC settlement that could be used against the defendant in the civil action. In regard to this issue, it is relevant to note that the OSC's mandate does not run to seeking compensation for redress of damage and loss for aggrieved stakeholders.

The proper regulatory policy of neutrality should be applied with respect to the consideration of implementing a No-Contest Settlement program. Settlements 'without admitting or denying' would follow regulatory neutrality in cases where there are no unrecouped losses to be sought by investors and shareholders reasonably attributed to the conduct of the settling respondents. The regulatory policy should neither prefer nor benefit either the plaintiffs' bar or corporate defense counsel, unless there is a clear public policy for so doing, which does not appear to be evident presently.

Indeed, as stated by the Supreme Court of Canada in the *Asbestos* decision quoted by the OSC and referred to below, "s. 127 cannot be used merely to remedy Securities Act misconduct

alleged to have caused harm or damages to private parties or individuals." Remedies to recover losses to investors and shareholders caused by securities law violations are left to private civil litigation and should not be negatively affected by OSC policy. .

Overview

The Proposals state that the No-Contest Settlement program would provide cooperating market participants and others subject to OSC enforcement actions a basis in which they "could resolve their enforcement matter without admitting facts or non-compliance with Ontario securities law or conduct contrary to the public interest." [underline added].

> [The underlined words in the quoted sentence are troublesome – how can a No-Contest Settlement be approved "without admitting facts"? This phrase may simply be mistaken wording as the Proposals state subsequently that " … in short, staff will not require, in appropriate cases, that a settling respondent admit a breach of the Act or specific conduct contrary to the public interest.". How this may work out in the language of No-Contest Settlement agreements remains to be discovered.]

The SEC evidently announced its policy of permitting settling respondents to consent to a judgment 'without admitting or denying' the allegations in November 1972 as part of the SEC's decision not to permit such respondents to deny the allegations in the consent judgment (SEC Release No. 33-5337, November 28, 1972 (*SEC News Digest*, Issue No. 72-227, November 28, 1972). This policy initiative included the following text:

> "The [Securities and Exchange] Commission has adopted the policy that in any civil lawsuit brought by it or in any administrative proceeding of an accusatory nature pending before it, it is important to avoid creating, or permitting to be created, an impression that a decree is being entered or a sanction imposed, when the conduct alleged did not, in fact, occur. Accordingly, it hereby announces its policy not to permit a defendant or respondent to consent to a judgment or order that imposes a sanction while denying the allegations in the complaint or order for proceedings. In this regard, the Commission believes that a refusal to admit the allegations is equivalent to a denial, unless the defendant or respondent states that he neither admits nor denies the allegations." [underline added]

SEC Commissioner Luis A. Aguilar, in a recent February 4, 2011 speech to the Practising Law Institute's *SEC Speaks in 2011*, provided a relevant and current perspective on securities law enforcement:

> "As we work to build a pro-active regulator, my second wish is that the SEC Division of Enforcement brings cases that have obvious deterrence value. I know that this is a wish that is shared

> by our Enforcement staff. This means that when the Commission announces the resolution of a matter we would notice a reaction that we haven't always witnessed.
>
> I envision a world where when the SEC announces a settlement in a high profile case, its impact is clearly noted — and leaves little doubt that it will make people that are engaged in similar activities think twice. An enforcement action by the SEC should be serious business, and it should cause an organization to seriously review how it has been operating. Moreover, our enforcement actions should have market-wide impact, and there should be sanctions that are significant enough to stop similar conduct in its tracks. *The possibility of being sanctioned by the Commission should not be considered part of the cost of doing business.*
>
> I envision a world where our remedies are calibrated to be meaningful, not merely routine - and where federal judges can clearly see that the SEC understands its mission and seeks to protect investors and deter wrongdoers by obtaining appropriate sanctions and meaningful deterrence.
>
> *An additional wish for 2011 is to see defendants take accountability for their violations and issue mea culpas to the public. I hope that 2011 brings an end to the press release issued by a defendant after a settlement explaining how the conduct was really not that bad or that the regulator over-reacted. I hope that this revisionist history in press releases will be a relic of the past. If not, it may be worth revisiting the Commission's practice of routinely accepting settlements from defendants who agree to sanctions "without admitting or denying" the misconduct.*" [underline and italics added]

The Public Interest Standard Requirement for Approval

In addition to other key requirements to this proposed program, such as the respondent having cooperated with the OSC staff, the Proposals state that the "No-Contest Settlement must meet the public interest requirements set out in the Act in respect of orders made pursuant to section 127." It is a critical and fundamental first principle that any No-Contest Settlement which does not contain admissions of any wrongdoing must be clearly and transparently assessed to be "in the public interest" before it can be approved.

The 'public interest', in cases involving No-Contest Settlements without admissions of wrongdoing, must address and satisfy investor and capital markets stakeholder interests beyond the interest of the OSC to reach a speedy settlement, without a lengthy proceeding that consumes its resources, and the interest of the settling respondent to pay a monetary fine and investigation costs, without admitting any wrongdoing, and then moving on to conduct its business as usual.

In addition to satisfying the public interest standard, it is suggested that there should be additional enunciated standards to be satisfied before approving any No-Contest Settlement, as well as clarifying principles to be applied in considering applications for approval of No-Contest Settlements negotiated by OSC staff.

It is also questionable that No-Contest Settlements should be approved and become effective without an open public settlement approval hearing and the public filing of the related agreements and documentation.

Principles and Standards of Review of No-Contest Settlements

While the Proposals state that a No-Contest Settlement must meet the public interest requirements of the Act in respect of orders made under section 127, the question remains whether satisfying this 'public interest' test is the only or the sufficient standard for approval of No-Contest Settlements? The Proposals also state that No-Contest Settlements will be available to market participants and others "in appropriate circumstances". What are these "appropriate circumstances"?

In connection with SEC negotiated consent judgments 'without admitting or denying' the allegations of misfeasance in the complaint, the standard of review by the court is "whether the proposed Consent Judgment … is fair, reasonable, adequate, and in the public interest." (*SEC v Citigroup Global Markets Inc.*, 11 Civ. 7387 (Southern District of New York), Opinion and Order, filed November 28, 2011, Rakoff, U.S.D.J.).

In the most encompassing sense, it might be argued that all the factors that the OSC merits hearing panel takes into account and assesses may meld together to formulate a judgment which, in the reasonably exercised discretion of the panel, the OSC determines to be "in the public interest". As noted by Judge Rakoff in the above *Citigroup* opinion, there may not be a meaningful severance between the requirement that the settlement be "in the public interest", as well as be 'fair, reasonable and adequate', as all those requirements inform each other.

It is suggested, however, that a perspective that the settlement only needs to be "in the public interest" may be not only amorphous but too narrow at the same time. It could be argued that approving any No-Consent Settlement is "in the public interest" on the grounds that, for instance, it assists the OSC in the efficiency of its enforcement process, expedites resolution of disputes, avoids lengthy, expensive and unpredictable proceedings for the OSC, encourages cooperation that may assist in other enforcements, reduces costs, lessens the administrative burden of the OSC on the marketplace and frees the currently limited enforcement resources of the OSC for other initiatives. Such a telescope focus, however, may not provide appropriate weighting to the facts of the specific case and the perhaps severe consequences and large losses that the impugned (and perhaps, abusive and grossly negligent) conduct had on innocent investors, the integrity of the capital markets and related issues. The factors referred to above do serve the immediate interests of the parties to the No-Contest Settlement (the OSC and the respondents), and are proper considerations, but may not concurrently serve the broader societal interests, including those of the investing public, particularly their trust in the integrity of the markets.

In a No-Contest Settlement, the agreement does not assist in supporting private civil actions for the purpose of recouping investors' losses as injured private investors cannot derive any benefit from a settlement by the alleged wrongdoers with the OSC where there is no admission of violations or facts upon which breaches may be judged in other forums. In addition, there is the further troublesome issue, where a corporate respondent agrees to a No-Contest Settlement, that the effect is that the costs of the settlement are borne by the innocent shareholders of the corporation and not by the individuals who caused or acquiesced in the problems at issue. From the perspective of the individuals who were involved in the conduct in question, it is much easier to agree with the OSC to solve the investigation by having the corporation bear the cost of the settlement, especially where there is no admission of misconduct. Unfair or unreasonable terms may not only be those which impose penalties or prohibitions that are too severe, but also remedies which are not adequate or strong enough in the circumstances of the case. In the latter circumstances, it is often considered that modest, or inadequate, penalties are considered as 'the cost of doing business' and regarded as required to maintain a working relationship with the regulatory agency.

In most cases, the terms of a No-Contest Settlement may be fair, reasonable and adequate and in the public interest. But, can the approval of unfair, unreasonable or inadequate terms of a No-Contest Settlement (considered in the circumstances of the specific case) be 'in the public interest'? If, in the context of the specific case, the terms of the No-Contest Settlement should be fair, reasonable and adequate, in addition to being 'in the public interest', what are the standards of fairness, reasonableness and adequacy?

In Judge Rakoff's opinion, the standard of 'fairness' must be considered in the context of the question: 'fair to whom?'. His answer is: fair to the parties and to the public. Judge Rakoff further noted that the approving body (in the United States, the court) must "be satisfied that it is not being used as a tool to enforce an agreement that is unfair, unreasonable, inadequate, or in contravention of the public interest."

In the *Citigroup* opinion, Judge Rakoff did not approve the consent settlement agreed between the SEC and the respondent because (at pp.8-9):

> "it does not provide the Court with a sufficient evidentiary basis to know whether the requested relief is justified under any of these standards. Purely private parties can settle a case without ever agreeing on the facts, for all that is required is that a plaintiff dismiss his complaint. But when a public agency asks a court to become its partner in enforcement by imposing wide-ranging injunctive remedies on a defendant, enforced by the formidable judicial power of contempt, the court, and the public, need some knowledge of what the underlying facts are: for otherwise, the court becomes a mere handmaiden to a settlement privately negotiated on the basis of unknown facts, while the public is deprived of ever knowing the truth in a matter of obvious public importance."

Judge Rakoff then concluded, significantly, that "the parties' successful resolution of their competing interests cannot be automatically equated with the public interest, especially in the absence of a factual base on which to assess whether the resolution was fair, adequate, and reasonable." (at p.13). In conclusion, Judge Rakoff dismissed the application for approval of the agreed settlement between the SEC and Citigroup, stating (at p.14):

> "It is not reasonable, because how can it ever be reasonable to impose substantial relief on the basis of mere allegations? It is not fair, because, despite Citigroup's nominal consent, the potential for abuse in imposing penalties on the basis of facts that are neither proven nor acknowledged is patent. It is not adequate, because, in the absence of any facts, the Court lacks a framework for determining adequacy. And, most obviously, the proposed Consent Judgment does not serve the public interest, because it asks the Court to employ its power and assert its authority when it does not know the facts."

Impact of No-Contest Settlements on Injured Investors' Private Civil Causes of Action

In considering the possible adoption of a No-Contest Settlement program in Ontario, and before deciding to proceed with such a new policy, the OSC should review and publish a full analysis for comment dealing with whether and the degree to which, if any, the implementation of negotiated settlements of OSC enforcement actions, where the settling respondents neither admit nor deny any allegations of wrongdoing, may affect investors and shareholder private rights of action to seek appropriate redress for injury and losses suffered from alleged securities law violations.

Under "Impact of Civil Litigation on Enforcement Activity", the OSC staff are submitting that the possibility of separate civil litigation against wrongdoers negatively impacts its investigative work and adversely affects the OSC staff's ability to reach an enforcement settlement with such wrongdoers on a timely basis "because such respondents are concerned that admissions they make in OSC proceedings (which are public) will be used against them in civil litigation.". They OSC staff say that the primary barrier to resolution is the issue of admissions and not the appropriate sanction. While there is no reason in the public domain to question these assertions, the mere statement of these points in an OSC Staff Notice with respect to obstacles in its way to settlement is not a sufficient basis to conclude that there is not either additional ways to solve the asserted enforcement issues before the OSC or that it is 'in the public interest' to introduce policies that operate for an overriding principal stated purpose of reaching more settlements in OSC enforcement proceedings.,

It is recognized that there is a valid issue of how to balance delicately the ability of the public agency, the OSC, to fulfill its statutory mandate, in part by reaching settlements for allegations of violations of securities law (the settlement of which on appropriate terms also serve other aspects of the broader 'public interest'), with the important private rights of investors and shareholders to be able to pursue their own remedies for just and fair restitution for losses they have suffered due to the alleged wrongdoing of others.

It does not appear clear to me, at this juncture, that the Solomon solution is to favour the public enforcement agency to the potential detriment of the private civil remedies available to investors and stakeholders.

The OSC continually refers to the deterrent effect of its enforcement activities, which basically means dealing with prospective and preventive remedies for future potential violations. That objective is appropriate, however, it is equally important that investors have the ability to seek compensation and redress for past improper actions that have caused them damage. Private civil actions are not parallel litigious proceedings to the OSC's public enforcement actions. Investor's private civil litigation addresses a separate and important issue of public policy outside the scope of the OSC's jurisdiction and mandate, namely, compensation for those investors who have been injured by wrongdoing. The prospective and preventive orientation of the OSC should not suppress the ability of investors to redress prior violations that have caused them damage.

The better public policy is to ensure that the regulatory enforcement regime is neutral with respect to its effect on securities private civil actions, including class-action suits, to redress alleged wrongdoing. .

If there is a further restriction or encumbrance on private rights of action to seek redress in the civil courts for injury and loss suffered from alleged securities law violations, then there is a serious question whether the adoption of a No-Contest Settlement program is in the broader 'public interest'.

I do not think that this bifurcation of the broader 'public interest' in relation to the protection of investors into the public enforcement mandate, on the one side, and the private civil redress of injury in the civil courts, on the other, results in an irreconcilable stalemate (where only the wrongdoers would benefit) between the enforcement abilities of the public agency and the protection of the interests of investors and stakeholders.

Public (OSC) enforcement proceedings and private (investor) causes of action are complementary securities law enforcement tools, and they are critically interrelated. It is not in the public interest that public (OSC) enforcement policies be adopted and implemented which operate to the detriment of the abilities of investors and shareholders to exercise their statutory or common rights to seek private redress for injury and losses that they have suffered and for which the OSC does not seek to provide any restitution or compensation.

Indeed, it may be suggested that it is rather more clearly in the public interest and for the benefit of the integrity of our country's capital markets and its participants, including investors, that private rights of action be expanded, and not indirectly reduced or curtailed by any unintended consequences of potentially ill-designed publicly administered enforcement policies.

On the basis that the exercise of the OSC's public interest jurisdiction under section 127 is to be protective and preventive and intended to forestall likely future harm in Ontario capital markets, the adoption of a No-Contest Settlement program must clearly operate to fulfill this mandate and not to extend to apply to subject matters beyond its jurisdiction.

In the *Coventree* Reasons for Decision[1], the OSC quoted the following instructions of the Supreme Court of Canada from the *Asbestos* decision with respect to two constraints on the OSC's public interest discretion as follows:[2]

> "In exercising its discretion, the OSC should consider the protection of investors and the efficiency of, and public confidence in, capital markets generally. In addition, s. 127(1) is a regulatory provision. The sanctions under the section are preventive in nature and prospective in orientation. Therefore, s. 127 cannot be used merely to remedy Securities Act misconduct alleged to have caused harm or damages to private parties or individuals."

In its Reasons for Decision and Order in *In the Matter of Magna International Inc.*[3], the OSC made the following comments:

> "The Commission's public interest jurisdiction is animated by the purposes set out in subsection 1.1 of the Act, namely (i) to provide protection to investors from unfair, improper or fraudulent practices, and (ii) to foster fair and efficient capital markets and confidence in capital markets. As a result, the Commission must consider the fair treatment of investors, capital market efficiencies and public confidence in capital markets when exercising its public interest jurisdiction (*Asbestos, supra* at para. 41)".

In light of these constraints on its own jurisdiction, it would not be appropriate for the OSC to adopt enforcement policies which may have the effect of impacting negatively on private parties and individuals from using civil proceedings to remedy Securities Act and other misconduct they may allege has caused them harm or damages.

Fines, Penalties and Costs: Who Should Pay? Why Should the Innocent Shareholders?

In the case of public reporting issuers (as opposed to market participants which are registrants), fines, penalties and costs administered by the OSC in its successful enforcement actions are often paid, directly or indirectly, by the reporting issuer, and not by the individuals who were actors in the improper conduct. Where monetary obligations are in fact levied against individuals who are directors, officers or employees of reporting issuers, they are usually entitled to offload these pecuniary outlays, including legal fees for their own separate defense counsel, to and obtain reimbursement of these "expenses" from the reporting issuer through personal contractual indemnity agreements, corporate by-law protections and D&O insurance policies funded by the reporting issuer.

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[1] See footnote 5 below and the Reasons for Decision, at para. 806.

[2] *Committee for the Equal Treatment of Asbestos Minority Shareholders v Ontario Securities Commission*, [2001] 2 S.C.R. 132, at para. 45.

[3] *In the Matter of Magna International Inc.*, 34 OSCB 1290 (February 4, 2011), at para. 181 (Reasons for Decision and Order dated January 31, 2011).

The OSC has the ability and should exercise its powers to prevent fines, penalties and costs ordered to be paid by directors, officers or employees of reporting issuers who authorized, permitted or acquiesced in the alleged wrongful conduct of the reporting issuer (including in any No-Contest Settlements) from being submitted by the settling respondents for payment by or reimbursement from the reporting issuer, akin to a corporate expense claim they incurred in carrying on business in the ordinary course..

In connection with OSC's approval of the RIM settlement agreement between Jim Balsillie, Mike Lazaridis and others, the Chair of the OCS panel noted that both RIM and the individual respondents "have admitted in the Settlement Agreement that: … they backdated or repriced Options with a total 'in-the-money' benefit of approximately $66 million"; … . The OSC order approving that settlement agreement included a requirement that:

> "k. the Individual Respondents will not seek, accept, or be offered indemnification from or through RIM for any of the payments associated with or paid by the Individual Respondents as a result of this settlement and this order." [4]

In the case of *In the Matter of Coventree Inc., Geoffrey Cornish and Dean Tai* [5], in its decision following a contested adversarial enforcement hearing and a subsequent sanctions hearing, the OSC ordered Coventree, the reporting issuer, to pay a penalty of $1 million and costs of $250,000, and each of Cornish and Tai to pay a penalty of $500,000 (paragraph (h)). In contrast to the RIM case, the individual respondents did not admit to any wrongdoing, but the OSC held that they 'authorized, permitted or acquiesced' in Coventree's non-compliance with securities law and therefore that they committed a securities violation themselves, 'contrary to the public interest'. The OSC then further ordered that:

> "(j) for greater certainty, this Order is not intended to prevent Cornish or Tai making any claim for indemnity from Coventree in respect of the amounts payable by them pursuant to paragraph (h) of this Order;".

The imposition by the OSC of fines, penalties and costs on the reporting issuer for past allegedly improper conduct of its directors, officers or employees is, in effect, further indirect economic burdens that are borne by the relatively innocent owner shareholders and other stakeholders in the company in question. These enforcement fines, costs and penalties imposed by the OSC on the reporting issuer and effectively economically borne by its shareholders are in addition to the often concurrent financial losses the stakeholders may have already suffered as a result of the decline in the market price and value of their publicly traded security holdings

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[4] For a review of the RIM settlement agreements with the OSC, see "*Research in Motion – The 10 Year Option Trading Scandal*", at http://www.governancecanada.com/.

[5] *Coventree et al.*, 34 OSCB 10209 (October 7, 2011); Reasons for Decision September 28, 2011 (http://www.osc.gov.on.ca/en/Proceedings_rad_20110928_coventree.htm). Sanctions Order dated November 8, 2011 (http://www.osc.gov.on.ca/en/Proceedings_rad_20111108_coventree.htm).

associated with the disclosure of problematic ethical practices and misbehaviour of the company's directors, officers or employees .

Shareholders and investors should not indirectly bear the enforcement costs in allegedly ("without admitting or denying") improper conduct of directors, officers or employees of their companies. No-Contest Settlements should not support nor increase the financial burden on the company's stakeholders, as well as not impeding the private rights of action of injured stakeholders to seek redress from alleged wrongdoers.

Independence of the Adjudicative Panel

There is a continuing public interest issue concerning the appropriateness of combining the enforcement/prosecutional and the adjudicative functions for investigating and the determining and judging securities law offences within the same integrated agency, such as the OSC. Advocates of the continuance of the unitary system for this aspect of securities law administration in Ontario argue that it is important that the adjudication function be linked to the enforcement branch because it will be aware and in effect be part of the formulation of the policy objectives of the OSC. The merits of this analysis are subject to ongoing debate.

The formation of a separate securities adjudicative panel was recommended by an independent committee headed by Ontario's then Integrity Commissioner, The Honourable Coulter A. Osborne, Q.C., *"Report of the Fairness Committee to the Ontario Securities Commission"*. In its 104-page report, dated March 5, 2004, the Osborne Committee strongly advised the OSC to separate its adjudicative function, noting that "the arguments supported by the evidence in favour of this separation are persuasive, indeed overwhelming." In its view, "the apprehension of bias has become sufficiently acute as to not only undermine the Commission's adjudicative process, but also the integrity of the Commission as a whole."

As long as the concept of a single integrated securities regulatory agency continues to receive acceptance in Ontario, it is vitally and critically important that the OSC body (the merits hearing panel) that presides over and determines whether or not to approve, reject or amend the terms of a No-Contest Settlement that has been negotiated by its staff, is, and is accepted as being, completely independent of the parties to the No-Contest Settlement agreement. The OSC merits hearing panel must exercise its discretion in a fair and objective manner, and be perceived to be able to adjudicate on the merits of the No-Contest Settlement on an impartial and disinterested basis.

> [This is not an argument concerning the integrity of the OSC commissioners who compose the merits hearing panel, from time to time. It is rather an issue of a systemic neutrality deficiency or a perceived structurally created predisposition from association.]
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> [As the OSC would itself also authorize the terms of any policy that implements a No-Contest Settlements program recommended by its staff, the OSC will bear the burden of satisfying the public that its internal process of approving the recommendations of its own enforcement branch for settlements 'without admitting or

> denying' is itself 'in the public interest'. The counter position is that, having approved the policy, the merits hearing panel can implement the OSC's own objectives. Herein is another potential public interest conflict: to whom and how is the OSC accountable?]

The Proposals include a reference to the "greater use of voluntary settlement agreements (where appropriate) entered into between OSC staff and respondents that may be approved by the Executive Director under the *Guidelines for the Approval by the Executive Director of Settlements of Enforcement Matters … .*"

This statement is most unclear and ambiguous and its implications may be in contradiction to the principles submitted in this comment related to open and transparent procedures that apply publicly based policies and standards without adverse consequences to the private civil rights of stakeholders where the settlements are approved by an independent administrative authority.

Process and Procedures for Dealing with No-Contest Settlements

It is submitted that, in connection with the procedure and decision-making process to determine whether or not to approve a No-Contest Settlement without admissions of any wrongdoing,

1. the agreement and related documents should by publicly filed and contain a transparent and adequate description of the underlying and relevant factors in order that the public is fully informed of the material facts in respect of which the proposed settlement is considered to be fair, reasonable and adequate and in the public interest in relation to the circumstances and the behaviour of the settling respondents;

2. the merits hearing panel to consider whether the agreement should or should not be approved should be in a position to exercise a completely independent judgement. In this regard, the mertis hearing panel should be composed only of members who are completely independent and not part of or involved in any discussions or negotiations concerning the OSC's enforcement activities concerning the matter or the settlement of the agreement and should not be involved in any pre-hearing conferences that may precede the merits hearing;

3. the OSC Rules of Procedure should be amended, among other things, to prohibit a member of the merits hearing panel from being a member of a pre-hearing conference panel is respect of the same No-Contest Settlement;

4. the hearing referred to in item 2 should be public and not in camera;

5. written reasons from the independent panel should be required to be publicly published setting out the basis and reasons for the panel's decision to approve, not approve, or to approve the No-Contest Settlement subject to amendments, terms or conditions;

6. the OSC Rules of Procedure should be amended to provide for the foregoing and to remove any right or discretion of the OSC to amend or waive such public interest, open and transparent procedural safeguards in respect of a No-Contest Settlement.

The OSC Rules of Procedure that are suggested to be reviewed and revised in the context of introducing a new No-Contest Settlement program are listed in Schedule A attached to this comment letter.

Yours very truly,

(signed) "HG EMERSON"

H. Garfield Emerson, Q.C.

References:

Crowell & Moring LLP, *"To Neither Admit Nor Deny: SEC Litigation Position Reiterates Need to Examine Standard Provisions in SEC Settlements"* (April 2001).

"Report of the Fairness Committee to the Ontario Securities Commission" (March 5, 2004).

Securities and Exchange Commission v. Citigroup Global Markets Inc., 11-Civ-7387 (Rakoff, J.,) (S.D.N.Y. filed October 19, 2011). Order of Rakoff, J., filed October 27, 2011; Opinion and Order of Rakoff, J., filed November 28, 2011.

SEC Commissioner Luis A. Aguilar, *"Setting Forth Aspirations for 2011"*, Address to Practising Law Institute's '*SEC Speaks in 2011'* (February 4, 2011).

SEC Commissioner Elisse Walter, *"The Interrelationship Between Public and Private Securities Enforcement"*, The Harvard Law School Forum on Corporate Governance and Financial Regulation (December 11, 2011).

SEC News Digest (Issue No. 72-227), *"Policy re Consent Orders Announced"* (November 28, 1972).

SEC Litigation Release No. 22134, *"Securities and Exchange Commission v. Citigroup Global Markets Inc.*, 11-Civ.- 7387 (Rakoff, J.,) (S.D.N.Y. filed Oct. 19, 2011) (October 19, 2011).

SEC Release No. 34-61340, *"Policy Statement Concerning Cooperation by Individuals in its Investigations and Related Enforcement Actions"* (January 19, 2010).

SCHEDULE A

ONTARIO SECURITIES COMMISSION RULES OF PROCEDURE

(Amendment and Consolidation as of August 31, 2010)

"1.4 Procedural Directions or Orders by a Panel – …

(3) A Panel may waive or vary any of the Rules in respect of any proceeding before it, if it is of the opinion that to do so would be in the public interest or that it would otherwise be advisable to secure the just and expeditious determination of the matters in issue."

Comment: There should be restrictions on the right of the Panel to waive or vary the Rules in respect of the procedure for a merits hearing panel reviewing a No-Contest Settlement. It is in the public interest that the Rules for reviewing a No-Contest Settlement without admission of wrongdoing provide for a process that is open and transparent, fair and fixed so that the public's right to information regarding the administration of the Act in regard to this sensitive and important enforcement program is clear and accessible.

"12.1 Purpose of Settlement Conference – (1) The purpose of a settlement conference is to provide the parties with the opportunity, prior to proceeding to a hearing under this Rule to approve a settlement agreement, to make confidential submissions on a proposed settlement to a Panel in order to obtain guidance on whether the terms of the proposed settlement would, in the view of the Panel, be in the public interest.

Comment: It is important that there be an absolute separation of any members participating in a confidential settlement conference from the members composing a subsequent merits hearing Panel reviewing a No-Contest Settlement in order to preserve the independence and objectivity of the judgment of the merits hearing Panel. The decision of the merits Panel should be based solely on the evidence, facts and submissions introduced and made and available at the public merits Panel hearing, and not based in any way on confidential submissions, non-public evidence or discussions or information at an in camera settlement conference or any other private or non-public meeting between the settling respondents and an OSC Panel or potential merits hearing Panel members. The hearing of the merits Panel should be open to the public without any confidential submissions or information

relating to the issues subject to the No-Contest Settlement that is not available to and accessible by the public.

(2) At least one settlement conference shall be held before a hearing to approve the settlement agreement."

"12.6 No Communication to Panel Hearing the Merits – In the event that the matter subject to the settlement conference proceeds to a hearing on the merits, the Panel presiding at the settlement conference shall not participate in the hearing on the merits and no communication made at the settlement conference shall be disclosed to the Panel hearing the matter on the merits."

Comment: Rule 12.6 appears inconsistent with Rule 12.9.

"12.9 Settlement Hearing Panel – The Panel presiding at the hearing to approve the settlement shall be one or more of the members of the Panel that presided at the settlement conference."

Comment: This Rule should be amended to prohibit a member of the Panel at a settlement conference on a No-Contest Settlement from participating in the merits hearing Panel on the same settlement in order to maintain the independence and objectivity of the merits Panel. [See, Report of the Fairness Committees to the Ontario Securities Commission]

"**12.11 Publication of Settlement Agreement When Approved** – The order approving the settlement agreement, the settlement agreement, and the Panel's reasons, if any, shall be posted on the Commission's website and in the *Bulletin* forthwith following approval of the settlement agreement by the Panel, unless otherwise ordered by the Panel."

Comment: The merits hearing panel on a No-Contest Settlement should be required to issue written reason for its decision and to publish such reasons and the order on the OSC website and in the Bulletin. Rule 12.10(2) should be amended to require written reasons.