Corporate Securities

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OSC PROPOSES CORPORATE GOVERNANCE RULES

On January 16, 2004, the Ontario Securities Commission (OSC) released for comment a proposed rule and a proposed policy that are designed to replace the corporate governance guidelines of the Toronto Stock Exchange (TSX). The TSX intends to revoke its corporate governance guidelines and related disclosure requirements when the OSC proposals become effective. With the exception of British Columbia and Quebec, the provincial and territorial securities regulators across Canada also are considering the OSC proposals.

The policy outlines recommended "best practices" for effective corporate governance, while the proposed rule prescribes disclosure requirements in respect of governance-related matters and the filing of any written code of business conduct and ethics that an issuer has adopted. These disclosure requirements may create market pressure on issuers to adopt the corporate governance practices suggested by the OSC.

The proposals, in large part, follow the corporate governance listing standards of the New York Stock Exchange (NYSE) and the amendments proposed by the TSX to its guidelines in the Spring of 2002 and amended later that year. Issuers that already comply with the NYSE listing standards, or with the amendments to the TSX guidelines that were proposed but never finalized, will largely be unaffected by the OSC's proposed rules.

The main differences between the proposals and the existing TSX guidelines, are new recommendations that:

- compensation committee and nominating committee be composed entirely of independent directors,
- a formal board mandate and charter for each of the nominating committee and compensation committee be adopted and disclosed,
- an annual assessment be undertaken of the board, its committees and each individual director,
- a code of business conduct and ethics be adopted and, if adopted, disclosed (as well as any amendments and waivers to the code), and
- tightening the definition of "independence" for directors.

The proposals apply to income trusts as well as corporate issuers. There is no scheduled implementation date for the proposals. The comment period expires April 15, 2004.

Recommended Best Practices

The proposed policy contemplates that every reporting issuer should consider the following recommendations, which the OSC believes are relevant to good governance.

Director Independence

- A majority of the board should be composed of independent directors. The policy maintains the TSX definition of independence - having no direct or indirect material relationship with the issuer - but deems certain persons (including those who have employment relationships with the issuer or its auditors, who receive payments in excess of $75,000 in direct compensation from the issuer (other than director fees) or immediate family members of such persons) not to be independent. The list of persons deemed not to be independent is similar to the NYSE criteria and includes the criteria that apply to independence of audit committee members under the new Multilateral Instrument 52-110 - Audit Committees, other than the restrictions on consultants and controlling shareholders. The prescribed period for determining these relationships is a three-year look-back period, but only going back to March 30, 2004.

- Independent board members should hold separate regularly scheduled meetings at which members of management are not in attendance.

- The chair of the board should be independent. If the chair is not independent, the board should appoint an independent director to act as "lead director" and effectively lead the board (including ensuring that the board's agenda will enable it to successfully carry out its duties).

- The board should adopt a written mandate in which it explicitly assumes responsibility for the stewardship of the issuer, which includes, among other things, responsibility for satisfying itself as to the integrity of the CEO and other senior officers and that the CEO and other senior officers create a culture of integrity throughout the organization, adopting a strategic planning process and approving, on at least an annual basis, a strategic plan which takes into account, among other things, the opportunities and risks of the business, and ensuring the integrity of the issuer's internal control and management information systems. The mandate should also set out the decisions requiring approval of the board, measures for receiving feedback from shareholders, and the board's expectations of management.

Code of Business Conduct and Ethics

- The board should adopt a code of business conduct and ethics for directors, officers and employees. The code should address conflicts of interest, protection and proper use of corporate assets and opportunities, confidentiality of corporate information, fair dealing with shareholders, customers, suppliers, competitors and employees, compliance with laws, rules and regulations, and reporting of any illegal or unethical behaviour.

- The board should monitor compliance with the code of ethics. Any waivers from the code should be granted only by the board (or a board committee).

Position Descriptions

- The board should develop written position descriptions for the roles of the chair, the chair of each committee and directors generally.

- The board, together with the CEO, should develop a clear position description for the CEO, which should include delineating management's responsibilities. The board should also develop or approve the corporate goals and objectives that the CEO is responsible for meeting.

Orientation and Continuing Education

- The board should ensure that all new directors receive a comprehensive orientation regarding the board and its committees and the nature and operation of the issuer's business, as well as continuing education opportunities.

Committees of the Board

- The board should have a nominating committee composed entirely of independent directors. The nominating committee should have a written charter establishing the committee's purpose, responsibilities (including identifying and recommending individuals qualified to become new board members), member qualifications, member appointment and removal, structure and operations (including any authority to delegate to individual members and subcommittees) and manner of reporting to the board. Prior to nominating or appointing directors, the board should consider the competencies and skills the board, as a whole, should possess and assess the competencies and skills each existing director possesses. The nominating committee should have authority to engage and compensate any outside advisor as it determines necessary.

- The board should have a compensation committee composed entirely of independent directors. The compensation committee should have a written charter establishing the committee's purpose, responsibilities (including reviewing and approving corporate goals and objectives relevant to CEO compensation, evaluating the CEO's performance in light of those goals and making recommendations to the board with respect to the CEO's compensation level based on this evaluation, making recommendations to the board with respect to non-CEO compensation, incentive-compensation plans and equity-based plans and reviewing executive compensation disclosure before it is publicly disclosed), member qualifications, member appointment and removal, structure and operations (including any authority to delegate to individual members and subcommittees) and manner of reporting to the board. The compensation committee should have authority to engage and compensate any outside advisor as it determines necessary.

Board Assessment

- The board should regularly assess its own effectiveness and performance as well as the effectiveness and performance of each committee and board member.

Disclosure

Notwithstanding that the practices outlined in the proposed policy are only "recommendations", they are given greater force through the disclosure that will be required in annual information forms (or management information circulars for TSX Venture issuers). The proposed rule contemplates that issuers will disclose in detail in their AIF, on a line-by-line basis, whether they comply with the practices recommended by the proposed policy, and if not, why. Issuers listed on the TSX Venture Exchange need only disclose whether they comply with the best practices related to director independence and code of business conduct and ethics.

Additionally, issuers will have to disclose in their AIF:

- a description of the lead director's roles and responsibilities,
- the text of the board mandate, and
- the text of the written charter for each of the nominating committee and compensation committee.

If an issuer has adopted a code of business conduct and ethics (as recommended), the code must be filed on SEDAR no later than the date for filing the annual financial statements. Any amendments to the code must be filed within 30 days after the board approves the final form of amendment. If any waivers from the code were granted, the AIF must include a description of the nature of the waiver, the name of the person to whom the waiver was granted, the basis for granting the waiver and the date of the waiver. A news release containing this information must also be filed on SEDAR.

Practical Implications

The proposals effectively implement most of the amendments that were proposed but never implemented by the TSX to its existing governance guidelines. For some issuers, relatively few changes will be required to their existing governance structure and disclosure practices, while others will need to evaluate and perhaps amend their governance and disclosure practices.

The enhanced disclosure is intended to provide the market with a more complete and transparent picture of a company's governance structure and practices. Without diminishing the importance of this transparency from a market perspective, it is important to note that this comprehensive governance disclosure increases potential for the market to "audit" a company's practices against its stated standards. In this context, non-compliance with stated standards will be more visible and may more easily give rise to litigation and/or liability. In addition, amendments to publicly available charters and policies will be more visible and may require greater explanation. In all instances, it will be important that issuers, their directors and management adopt responses to these regulatory initiatives that work, and that will be followed by them.

Additionally, the involvement of the OSC in setting these standards could lead to increased regulatory scrutiny of governance and governance disclosure and "public interest" proceedings where governance practices appeared to be "abusive of market expectations" in the context of the regulatory recommendations.

Please do not hesitate to contact any member of the Goodmans corporate securities team to discuss these initiatives, possible responses by you and your business, and corporate governance more broadly as it continues to evolve in Canada.

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