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VIA E-MAIL

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Financial and Consumer Affairs Authority of Saskatchewan
The Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission of New Brunswick
Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Superintendent of Securities, Yukon Territory
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Superintendent of Securities, Nunavut

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Re: CSA Consultation Paper 52-404 Approach to Director and Audit Committee
Member Independence

Dear Sirs/Mesdames:

I am providing comments on the foregoing consultation paper, based on my experience in advising issuer clients as to the application of the existing corporate governance disclosure requirements for 12930786.1

many years since the inception of such requirements, and the experience of my partners who practice in this area. I respond to your specific request for comments below:

As I focus specifically on certain deeming provisions, my comments do not follow the suggested format, although the comments address the questions in 2.

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1. The current “basic” test for independence, relating to relationships which could in the view of the issuer’s board of directors be reasonably expected to interfere with the exercise of a member’s independent judgment, has now been applied by issuers for some time, and directors, shareholders, the market and legal advisors are familiar with it. I submit that there is no need to change it.
2. However, it is entirely appropriate to consider whether the “deeming” rules, or at least some of them, continue to be appropriate. As described below, some are inconsistent, some lead to difficulty in applying the basic test and indeed some lead to misleading or inconsistent results.
3. Most importantly, it is time once and for all to delete the “deeming rule” that provides that officers and employees of affiliates (other than subsidiaries of the issuer), notably a controlling shareholder, are deemed to be not independent.

The entire rationale for the “independence” rules is to ensure that the members of board do not have any relationships which, by virtue of a relationship with the issuer or management, interfere with their judgement in supervising management, compensating management, and, if need be, terminating management. Typical examples of such relationships would be being part

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of the management team, or being dependent on management - such as the issuer being an important customer – or having a material financial relationship with the issuer other than director fees.

Directors who are closely related to controlling shareholders are not, inherently by virtue of that relationship, subject to such interference by virtue of a relationship with the issuer or management.

The opposite of “independent” is “dependent”. Directors who are related to a controlling shareholder (such as officers of the controlling shareholder) are not “dependent” on management of the issuer. They are in fact completely independent of management and have no conflicts in supervising management – they are in fact “more” independent than other “independent” directors. Such directors are aligned on almost all matters with all shareholders, such as compensation of executives, risk management, integrity of financial reporting, prudence in acquisitions – practically all matters a board is involved in. In fact, they are, if anything, more interested in getting these decisions “right” and in the interests of shareholders as they have a greater proportionate share in success or failure.

If it is important to have share ownership guidelines to align directors with shareholder interests, at what point does having more shares change that alignment?

Indeed, requiring issuers to disclose these directors as not independent is a “forced” misrepresentation, as in fact the opposite is true - they are board members who are fully independent of management.

This deeming provision leads to the anomalous position, for example, that the people most expert in the affairs of the corporation, and most interested in accurate financial reporting from management, are precluded from serving on its audit committee. This anomalous result becomes even more irrational and counterproductive when the controlling shareholder is a public company itself, whose employees cannot play an appropriate role in the governance of its major investments.

The one and only item where such directors are not so aligned are related party transactions, where there are transactions between the issuer, on the one hand, and the controlling shareholder or other of its affiliates, on the other.

Such transactions are not necessarily common at controlled public companies. They are very often a very small, and often immaterial, subset of issues addressed by the board.

Using the independence definition to regulate related party transactions is a non-targeted, ill-suited regulatory approach lacking any justifiable rationale. On any disciplined regulatory analysis, the costs of such an approach outweigh the benefits (if any). It is not clear in any event how identifying directors related to a controlling shareholder as not independent in a company with a controlling shareholder is an effective way to regulate related party transactions.

It is more consistent with sound public policy to adopt the approach taken by the TSX in its corporate governance disclosure rules, before the CSA assumed that jurisdiction, i.e., identify employees and officers of controlling shareholders who are on the board as related to the significant/controller shareholder, without deeming them not independent.

Related party transactions are addressed by the fiduciary duties of directors under corporate law, and related conflict of interest and oppression remedy provisions. To the extent it is thought existing corporate law, stock exchange rules, accounting rules, and securities rules (such as MI 61-101) do not adequately address and regulate related party transactions (which is not necessarily apparent), the CSA can enhance the provisions of MI 61-101 in a specific and targeted way.

4. Eliminating the deeming rule relating to affiliated entities would also facilitate eliminating a number of other confusing, convoluted and inconsistent provisions which were “tacked on” in an attempt to address the anomalous results of the “affiliated entity” deeming rule, such as
 - Employees from a parent company are deemed to be not independent, but directors from a parent company and its subsidiaries are not so deemed.
 - Addressing the anomaly that individuals from sister companies are not deemed to be not independent, while individuals from the parent company (however defined – see below) are.
 - Simplifying the rules to eliminate the “affiliated entity” deeming provision eliminates the need for the exceptions in sections 3.3 and 3.6 of NI 52-110 and the related disclosure, which tends to say, in essence, this affiliated entity is “really” independent, notwithstanding what the deeming rules say.
 - It would be appropriate and consistent to eliminate “and a parent of the issuer” from section 1.4(8) of NI 52-110. As it stands, the definition of issuer including a “parent

company” is in any event a trap for the unwary, as one’s normal reading of “issuer” would not naturally lead one to conclude that it included other companies. And, as the term “parent company” itself is not defined, and not otherwise used commonly in securities legislation, it potentially includes many companies. Does it mean the immediate holding company, only the ultimate parent company, or every company in between?

5. There are differing definitions of independence for the audit committee on the one hand, and for the board and all of the other committees, on the other hand. It is not at all clear why an audit committee member must be “more” independent than a member of the board generally (which is the ultimate governing authority) or a member, for example, of the compensation committee. It is also not clear investors appreciate the subtle distinctions being applied by issuers by segregating “1.5” directors from the audit committee.

This distinction produces anomalous results and, arguably, misleading disclosure. For example, partners in firms which have a significant relationship with the issuer are deemed non-independent under section 1.5 for audit committee purposes, but are not deemed non-independent for the board itself or other committees, because the partner himself did not receive amounts in direct compensation from the issuer. Although arguably he or she could still be found to be non-independent by virtue of the basic test, given that there are deeming provisions which specifically address the issue, it would be reasonable for a board to conclude that, as the individual is specifically caught by one deeming test and not the other, that he is independent under the “basic” test. Accordingly, the issuer discloses the partner is

independent, whereas, if the partner was on the audit committee, disclosure would be required that he was not independent.

Whether or not the separate test for audit committee members is retained, it is appropriate to at a minimum re-consider section 1.5 where the “benefit” also arguably outweighs the “costs”.

Section 1.4, of general application, provides for a threshold of non-director compensation an individual can directly receive before being deemed not independent - \$75,000.

However, if the individual is a partner in a firm, and the firm provides services to the issuer, section 1.5 provides that the individual is deemed non-independent, from dollar one of compensation to the firm – even though, in this context, the individual is by definition sharing the revenue with others.

In the current milieu, where many law firms are large, diverse, national or multinational enterprises, with hundreds of partners, and public companies often retain more than one law firm, it is not appropriate that an individual is effectively disqualified if his or her firm receives dollar one under a retainer from an issuer – which may not even having anything to do with the individual in question.

Lawyers familiar with public company issues are a great pool of nominees reflecting diversity and necessary expertise for clients which would enhance governance. On a true application of the test, there would be some consideration of the materiality of the retainer to the firm, and the relationship of the individual to the retainer. It is recognized however that such subjective measures may be difficult to administer and accordingly as an expedient some threshold should

be established. However, there should be some relationship between the amount which deems an individual to be non-independent and the amount a firm in which the individual is a partner receives – surely \$150,000 for a firm as twice the indicated amount for an individual would be reasonable.

Yours very truly,

John M. Tuzyk