IN FACT AND IN LAW

Securities
Corporate Governance

January 2005*

The New Corporate Governance Rules and Guidelines

By André Laurin

Summary

- TSX Guidelines to be replaced by rules and guidelines adopted or proposed by the Canadian Securities Administrators as soon as the latter come into force
- Mixed approach of rules and guidelines
- Generally, emphasis on integrity, independence, financial aspects and disclosure
- Same concepts and elements, but a somewhat different approach than in the U.S.
- More demanding criteria for the composition and independence of the Board and certain committees
- Adoption of a Code of business conduct and ethics
- Development of rules for boards and committees (audit, compensation and nominating) with strict and compulsory requirements in the case of the audit committee
- Various measures to ensure the financial integrity and accuracy of financial information disclosed
- Different and compulsory disclosure of corporate governance practices in the proxy circular (with possible sanctions in case of default)
- New continuous disclosure and audit rules, as well as additional accounting standards (with possible sanctions in case of default)
- Applicable to venture issuers, with exceptions and less strict requirements in certain cases

* This bulletin replaces the April 2004 bulletin, takes into account the revised and harmonized proposals of the CSA and offers certain additional precisions.

Preliminary Remarks

The Canadian Securities Administrators (the "CSA") have adopted rules relating to certification of financial information and internal controls by the CEO and CFO, audit committees, continuous disclosure and auditor oversight. These rules came into force on March 30, 2004, in most jurisdictions. Note that British Columbia has only approved the instrument pertaining to auditor oversight.

On January 16, 2004, these same authorities published for consultation proposed best practices in corporate governance and requirements for disclosure of practices followed.

The CSA staff has officially indicated that the proposed rules and guidelines will apply to Proxy circulars or annual information forms, as the case may be, that are filed after the end of the financial years ended on June 30, 2005 or later.

Quebec, Alberta and British Columbia (with certain differences at the level of the definition of independance in the latter case) support these latest proposed and harmonized rules and guidelines, which was not the case in connection with the January 2004 proposals.

The Toronto Stock Exchange ("TSX") Guidelines will be replaced by these rules and guidelines once they come into force.

The approach for corporate governance thus remains one of recommendations, rather than one of compulsory standards, except for certain aspects, such as those relating to financial information, audit committees and disclosure of practices followed. The CSA exercise regulatory control over reporting issuers through compulsory disclosure and certain peremptory rules.

The recommended rules and practices for corporate governance apply to almost all types of reporting issuers, including income funds other than investment funds and wholly owned subsidiaries (under certain conditions), whether those issuers are business corporations or other types of legal entities. However, certain rules, including those pertaining to audit committees and disclosure, are less demanding for issuers listed on the TSX Venture Exchange ("venture issuers"). The more significant differences are indicated in the "Highlights" section below in connection with the relevant rules or guidelines. Furthermore, exemptions are provided for the benefit of foreign issuers; however, this bulletin does not address these exemptions.

LAVERY, DE BILLY
BARRISTERS AND SOLICITORS

Effective Date

Generally, only the rules pertaining to the audit committee and those described in paragraph 14 below have already been adopted and came into force on March 30, 2004. The dates on which issuers have or will have to begin complying with these initial rules vary depending on the rule in question (please refer to the relevant regulations). The **guidelines** and **other rules** are merely **proposals**. According to the notice issued by the CSA staff, they will apply to the management information circulars or the annual information forms, as the case may be, after the end of the financial years ending on June 30, 2005, or later.

Reading Guide

Guideline: indicated by parentheses (guideline) and/or the use of the conditional (e.g., should).

Rule: indicated by parentheses (rule) and/or the use of the future tense (e.g., will).

Italics: identify an important difference from the TSX Guidelines.

Yellow: indicates a significant change to the guidelines or rules proposed in comparison with the January 2004 proposals. However, the January 2004 provisions which have been eliminated are not indicated.

Venture issuers: exceptions in parentheses and underlining of the words venture issuers.

Highlights

1. *The Board, as well as the nominating committee, compensation committee* (**guideline**) *and audit committee* (**rule**) *should each have a clear* ***mandate*** *defining their respective* ***responsibilities and duties****, as well as the* ***expectations*** *and responsibilities of directors (including attendance at meetings and prior review of documents). In the case of the Board, the mandate should cover integrity in general and financial integrity in particular, development of the issuer's corporate governance approach and measures for receiving feedback from security holders in addition to the elements already covered by the TSX Guidelines* (adoption of a strategic planning process, identification of principal risks, succession planning, adoption of a communications policy, responsibility for internal controls and management information systems, management supervision….). *For instance, it is recommended that the Board satisfy itself as to the integrity of the CEO and senior officers and the creation by them of a culture of integrity throughout the organization* (**guideline**).
2. The **Board** should be made up of a **majority of independent members** (**guideline**).
3. ***Three committees*** *will have to be* ***made up*** *entirely of* ***independent members***, namely the audit committee (**rule**), *the nominating committee and the compensation committee* (**guideline**). (See paragraph 15 below for additional comments on the audit committee.)

   The ***Chair of the Board*** *should be an independent director. Where it is not appropriate, an independent director should be appointed to act as "lead director". The independant Chair or "lead director" should act as the effective leader of the Board* (**guideline**).

   (It is important to note that venture issuers will benefit from a special exemption from the rules governing the composition of the audit committee. Although they must have an audit committee with a well-defined mandate, these issuers are not restricted as to the composition of this committee (i.e. number of members, their skills and their independent status)).
4. *The* ***notion of independence*** *is similar to that adopted in the U.S. (NYSE) and means generally the absence of a direct or indirect material relationship with the issuer. The criteria to determine independance are the same as those described in article 1.4 of Multilateral Instrument 52-110 Audit Committees* ***as modified***. ***Material relationship*** *is defined as a relationship which could, in the view of the issuer's Board of Directors, be reasonably expected to interfere with the exercise of a director's independent judgment. The definition includes several examples or presumptions of non-independance. There is a three (3) year cooling off period. Certain relationships which ended before March 30, 2004 are excluded from the presumptions* (**guideline**). *For members of the audit committee, the examples and presumptions are contained in a rule and include suppliers of services and members of affiliates in certain circumstances* (**rule**).

   Note that certain modifications that are proposed to Multilateral Instrument 52-110 Audit Committees also affect the proposed Multilateral Policy 58-201 Effective Corporate Governance at the level of the criteria of independence applicable to a director as a result of the reference made by the latter to the former. These modifications reorganize the paragraphs, bring the vocabulary closer to that used by the NYSE and offer certain precisions. For instance, for the purpose of determining the existence of a relationship, it is necessary to consider the relationship with the issuer's holding companies as though it were a relationship with the issuer itself or with its subsidiaries.

   (As mentioned above, venture issuers are exempt from the rules governing the composition of their audit committee.)
5. The independent members of the Board should hold separate and **regularly** scheduled **meetings**, **outside the presence** of management (**guideline**).
6. A **nominating committee** should be set up and should adopt a procedure for developing criteria regarding the composition of the Board, based on the issuer's needs, and for evaluating the existing directors, as well as nominee directors to be proposed to shareholders, again based on the same criteria (**guideline**).
7. The Board, the committees of the Board and the directors should be **assessed regularly** as to their **effectiveness** and contribution. For the Board and the committees, this assessment should take into consideration the mandate or charter of each, while in the case of the directors, it should take into account the position description of each director as well as the competencies and skills he or she was expected to bring to the Board (**guideline**).

André Laurin is a member of the Québec Bar and specializes in Business Law, particularly in Corporate Governance

8. The Board should develop a **description of tasks** and duties for the Chairman of the Board, the chairman of each committee and the CEO (in conjunction with him) and develop or approve the corporate goals and objectives that the CEO is responsible for meeting (**guideline**).

9. The members of the Board should be **trained and informed** both when they join the Board and on *a continuous basis thereafter* (**guideline**).

10. *A **compensation committee** should be set up to review and approve the objectives of the CEO, evaluate his performance, determine (or make recommendations to the Board with respect to) his compensation level and recommend his compensation based on the evaluation, make recommendations to the Board on the non-CEO officers and directors, on incentive compensation plans and equity-based plans and review the executive compensation disclosure to be made to shareholders before such disclosure is made* (**guideline**).

11. The Board, along with the nominating committee, compensation committee (**guideline**) and audit committee (**rule**), should all have the **right to retain and pay external advisers**.

12. *The Board should **approve a code of business conduct** and ethics and be responsible for **monitoring compliance** therewith. This Code should be applicable to the directors, officers and employees of the issuer and should set forth standards designed to promote integrity and deter wrongdoing. It should address the issues of compliance with the law and the internal policies (conflicts of interest, confidentiality, use of corporate assets and opportunities), fair dealing with the issuer's securitiyholders, customers, suppliers, competitors and employees and reporting of illegal or unethical behaviour. Any waiver granted for the benefit of a director or officer regarding compliance with the code should be approved in advance by the Board (or by a committee of the Board)* (**guideline**). *An issuer who has adopted a code of conduct must file it along with any amendment thereto on SEDAR. Conduct by an officer or director which constitutes a material departure from the code will likely constitute a "material change" within the meaning of Regulation 51-102 respecting Continuous Disclosure Obligations and trigger the obligation to disclose it publicly* (**rule**).

13. Each issuer will have to **disclose** in its management information circular (Proxy Circular) (or if it not required to send one, in its annual information form (AIF)) its **corporate governance practices** *in connection, more precisely, to certain subject matters covered by the guidelines (without having to explain why any particular guideline is not followed). The other directorships of the directors related to other issuers will also have to be disclosed. The list of independent directors and that of non-independent directors will also have to be disclosed by describing in the latter case the basis for that determination. This disclosure will have to comply with the prescribed rules* (See Form 58-101 F1) (**rule**). For the audit committee, the AIF disclosure requirement became a rule on March 30, 2004 (applicable to every issuer as of its first annual meeting after July 1, 2004), as Rule 52-110 has been adopted and is no longer only a proposal. The information that must be disclosed pursuant to Multilateral Instrument 52-110 Audit Committees has to be disclosed in the AIF with a cross-reference being made to the AIF in the Proxy Circular if the issuer solicits proxies and has to comply with Form 52-110F1.

    (Note that these disclosure requirements are not as extensive *in the case of venture issuers, which are only required to disclose certain aspects of their corporate governance practices. Furthermore, such disclosure must appear in the proxy circular, or where the venture issuer is not required to send such a circular, in its AIF or annual MD&A and must respect the requirements of Form 52-110F2. The more limited information that the venture issuers have to disclose pursuant to Multilateral Instrument 52-110 Audit Committees must appear in the proxy circular of such issuer, if it solicits proxies, or in its AIF or annual MD&A if it does not and they must respect the requirements of Form 52-110F2).*

14. *Issuers will also have to comply with certain rules regarding (a) **accounting principles**, (b) **continuous disclosure**, (c) **certification** of financial information and internal control systems with respect to the issuer by the CEO and the CFO, (d) the **auditors** and (e) **auditor oversight*** (**rule**).

    (Certain aspects of these rules are different in the case of venture issuers.)

15. *Multilateral Instrument 52-110 Audit Committees contains certain additional corporate governance rules for the audit committee. For instance*,

    a) *all **members** of the audit committee will have to be **financially literate***;

       (This requirement does not apply to venture issuers. However, the venture issuers will have to describe the relevant education and experience of each audit committee member in the proxy circular, the AIF or the MD&A, as may be required.)

    b) *for **members of the audit committee**, the **independence** rule will not have to be respected in its entirety during the first year following the date of the receipt for the prospectus, in the case of an initial public offering (at least one member has to be independent within the first 90 days and there must be a majority of independent members for the rest of the year). The mere fact that a director is a member of the Board of a company affiliated with the issuer does not necessarily disqualify him as an independent director* (**rule**);

       (As the independence rule for audit committee members does not apply to venture issuers, these exceptions are not pertinent in their case.) and

Notice to all non-reporting issuers

Although these rules and guidelines will apply only to reporting issuers, they will undoubtedly serve as criteria and standards from which private companies, cooperatives, Crown corporations, non-profit or charitable organisations and other similar entities should draw their inspiration to adopt their own corporate governance practices to the extent possible.

c) the **mandate of the audit committee** must include:

- *the recommendation to the Board of its choice of external auditor and his compensation*;
- *oversight of the work of the external auditor, including review of his services and resolution of disputes between management and the auditor regarding financial reporting;*
- *prior approval of all non-audit services to be provided to the issuer or any of its subsidiaries by the external auditor*;
- *the prior review of financial statements and the MD&A, as well as press releases dealing with the issuer's earnings*;
- *the verification of the implementation and adequacy of review procedures for the issuer's public disclosure of financial information extracted from or arising out of the issuer's financial statements;*
- *the establishment of procedures for (i) the treatment of complaints received by the issuer regarding accounting, internal accounting controls or auditing matters and (ii) the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing of the issuer; and*
- *the review and approval of the issuer's hiring policies regarding partners, employees and former partners and employees of the current and former external auditor.* (**rule**)

Additional Comments

Note that there is no explicit recommendation to set up a corporate governance committee, contrary to the NYSE recommendations to this effect. Also, it does not appear that the proposed guidelines will be in the form of listing requirements for a stock exchange, unless the TSX decides otherwise. American stock exchanges have incorporated the guidelines into listing requirements.

Upon request, we would be pleased to send you a table comparing the TSX Guidelines and the new rules or guidelines which have been adopted or proposed, as the case may be, as well as the relevant references. We also encourage you to read our newsletter on the new continuous disclosure rules entitled "New Continuous Disclosure Obligations Regime" published by Mr. Sébastien Vézina and Ms. Johanne Duchesne as well as our newsletter on the decision of the Supreme Court of Canada in the *Wise* case published by Ian Rose and Odette Jobin-Laberge. In this matter, the action against the directors and their insurer was dismissed. Our firm represented one of the defendants.

This text is only a summary and does not cover all nuances, features and exceptions. The proposed corporate governance rules and guidelines will very likely be adopted without significant changes.

Recommendation

Although, at the present time, not all the rules and guidelines have been adopted and none were in force at the time this bulletin was drafted, you should nevertheless review your practices as soon as possible. Our group specializing in corporate governance and our securities law team are available to help you do so (see our web site – www.laverydebilly.com).

André Laurin
(514) 877-2987
alaurin@lavery.qc.ca

You can contact any of the following members of the Corporate Governance and Securities Law groups in relation to this bulletin.

Corporate Governance

At our Montréal Office
Josianne Beaudry
Isabelle Lamarre
André Laurin

At our Québec City Office
Jacques R. Gingras

Securities

At our Montréal Office
Josianne Beaudry
Michel Blouin
René Branchaud
Georges Dubé
Martin Joyal
Isabelle Lamarre
André Laurin
Larry Markowitz
Jean Martel
Michel Servant
Sébastien Vézina

Montréal
Suite 4000
1 Place Ville Marie
Montréal, Quebec
H3B 4M4

Telephone:
(514) 871-1522
Fax:
(514) 871-8977

Québec City
Suite 500
925 chemin Saint-Louis
Québec City, Quebec
G1S 1C1

Telephone:
(418) 688-5000
Fax:
(418) 688-3458

Laval
Suite 500
3080 boul. Le Carrefour
Laval, Quebec
H7T 2R5

Telephone:
(450) 978-8100
Fax:
(450) 978-8111

Ottawa
Suite 1810
360 Albert Street
Ottawa, Ontario
K1R 7X7

Telephone:
(613) 594-4936
Fax:
(613) 594-8783

Web Site
www.laverydebilly.com

All rights of reproduction reserved. This bulletin provides our clients with general comments on recent legal developments. The text is not a legal opinion. Readers should not act solely on the basis of the information contained herein.