bcIMC Investment Management Corporation
Location: 3rd floor, 2940 Jutland Road, Victoria BC, V8T 5K6
Mailing Address: PO Box 9910, Stn Prov Govt, Victoria BC, V8W 9R1
Telephone (250): 356-0263 Facsimile: (250) 387-7874

November 14, 2005

BY E-MAIL

Mr. Tom Allen
Chair, IDA Task Force on Modernizing the CBCA
Suite 1600, 121 King Street West,
Toronto, Ontario M5H 3T9

Dear Mr. Allen:

Re: Comments on Modernizing the Securities Legislation in Canada

The British Columbia Investment Management Corporation (bcIMC) submitted comments to you on September 12th. We would like to expand on the corporate law and securities law issues raised in that letter. In particular, we would like to provide bcIMC's "buy side" perspective on two of the Task Force's research themes: investor protection and enforcement effectiveness. Our comments will combine theory and practice, using proven examples of weaknesses in Canadian corporate law and securities law that have been raised through cases such as YBM Magnex International, Nortel, Bre-X Minerals, Livent Inc., Cinar Corporation, Royal Group Technologies, and most recently, Norbourg Asset Management. The abuses and failings at these companies raised serious investor protection and enforcement effectiveness issues that we will outline here and, with the Task Force's permission, address in our private presentation in Vancouver on November 17th.

Introduction

From our view of the Canadian capital markets, the overarching need is for a clearly articulated and proactively enforced regulatory and legal environment that honours the interests of investors. Clear and unambiguous rules serve to promote investor protection and market efficiency as fewer resources need to be expended on the pursuit of legal remedies and on interpreting expected standards of conduct.

Investor Protection

a) Strengthening corporate governance and accountability to investors:

Directors who lack independence and are in a conflict of interest by having an economic relationship with the company should not be relied upon to protect the company and its investors. These issues were at the root of the YBM board's failure to protect the company and its shareholders from the alleged criminal activities of

company insiders and to disclose concerns about that conduct. Livent and Bre-X not only had boards dominated by insiders, but also had a majority of executives on their audit committees, a practice bcIMC rigorously condemns.

YBM, Livent, and Bre-X all violated the basic tenet of good governance by establishing boards and committees with insiders. The scandals at these firms that drained so much investor wealth in Canada may have been prevented if the companies had faced stricter corporate governance requirements regarding board and committee independence. bcIMC believes that people associated with management, underwriters, service providers and others with significant economic interests related to the company (other than shareholding in it and compensation received as a director) should be limited to holding a minority of a publicly traded company's board seats. At the very least, the requirement to disclose director relationships with the company needs to be enhanced - there must be thorough disclosure to investors of all relationships directors have to the company.

YBM was a fraud from the outset and Bre-X became a fraud. The success of each of these frauds required a board that failed to protect the interests of the company and its shareholders. Board negligence was also apparent in the poor director supervision of compensation plans at Nortel and Cinar. In Nortel's case, former CEOs John Roth and Frank Dunn were permitted to exercise millions of dollars in stock options that had been granted based on overstated financial results while investors were left with share values plummeting from $125 to less than a dollar. As for Cinar, its board gave the president and CEO control over stock option grants, a potential conflict of interest, and thereby usurped the role of the compensation committee. bcIMC feels strongly that directors should be required to demonstrate that they understand and have the skills, commitment and ethical standards necessary to live up to their fiduciary duties. Directors should be prohibited from serving on an excessive number of public company boards – in YBM's case, one director served on 15 boards. Directors should also be prohibited from serving on public company boards if they are found, in regulatory, civil or criminal proceedings, to have failed in their duties as directors. This would also apply to settlements reached through out-of-court negotiations when such failures are admitted. Finally, consideration should be given to requiring that all public company board members complete an accredited director education program. Completion or non-completion would be disclosed to shareholders.

Nortel, YBM, Bre-X, Livent and Cinar also taught us that directors must be made unambiguously aware that they are hired by – and work for – shareholders. Sending this message is difficult because of how directors are currently elected to the boards of federally incorporated companies. Management nominates directors, and shareholders are allowed to vote "yes" or withhold their votes, but they cannot vote "no" on the ballot. If 99 percent of the voters withhold, management's proposal for directors still passes.

So, even if disclosure of director relationships and performance were enhanced as we earlier suggested, the voting rules under the Canadian Business Corporation Act

(CBCA) do not facilitate director accountability. For public companies, a mechanism is needed to allow shareholders to vote against director candidates proposed by management without requiring a dissident proxy solicitation. The ability only to withhold one's vote is not sufficient.

Dual-class capital structures are another shareholder impediment to electing new board members. Democratic institutions are predicated on the concept of one person, one vote. In the context of corporate democracy, this equates to one share, one vote. However, in Canada many publicly traded corporations have at least two classes of shares with different voting rights. These structures are prejudicial to minority shareholders, whose voting rights are essentially meaningless, and undermines the objective of a healthy corporate democracy. bcIMC supports the concept of one share, one vote in publicly traded companies. Dual-class share and voting structures should be prohibited.

b) Improving financial reporting and disclosure:

In YBM, the corporate financial statements were out-and-out fabrications as was Bre-X's disclosure of its huge gold discovery; Nortel's fraudulent accounting practices have required numerous restatements; Royal Group Technologies is under investigation for fraud related to accounting practices and disclosures dating back to 1996; Livent collapsed in 1998 amid allegations of fraudulent manipulation of financial records to hide losses of $100 million; and Cinar became embroiled in an accounting scandal involving misused tax credits and offshore investments from which the company and its shareholders have never recovered.

Investors like bcIMC must be confident in the integrity and accuracy of corporate financial statements in order to make informed investment decisions. We must be confident that those responsible for the preparation of financial information are attentive to their duties. One way of encouraging this attentiveness is by enhancing the personal penalties and liability for contributing to any investor loss resulting from an error, omission or misstatement in corporate financial information or other investor disclosures. For this reason, bcIMC supports requiring the CEO and CFO to certify financial statements, and the imposition of joint ***and several*** liability (the CBCA has adopted a proportionate liability regime which we feel reduces the incentive for those responsible for the preparation of financial information to be attentive to their duties. Under a proportionate liability regime, parties have less concern for losses resulting from an error, misstatement or omission in corporate financial information because their degree of liability is limited to their contribution to the loss).

bcIMC supports the proposed legislative changes to eliminate the need to prove reliance in shareholder suits resulting from any share purchase, as is already the case for actions arising from prospectus purchases. Such a mechanism is included in the proposed Part XXIII.1, of the Ontario *Securities Act,* which is set to come into force at the end of the year and in section 90 of the new BC *Securities Act,* which

has not yet been proclaimed in force. These provisions apply to other disclosure as well. bcIMC supports the timely proclamation of these changes.

c) Enhancing the quality of the audit process:

The work of Royal Group Technologies' audit committee and external auditor, KPMG, have recently come under review by the RCMP for not delving deeper into the firm's related party transactions. While KPMG, like all auditing companies, relies on management and directors to disclose related party transactions, the RCMP notes it is also essential that KPMG perform certain procedures to identify these transactions, such as reviewing minutes from past meetings of shareholders, the board of directors and audit committees to find evidence of related party transactions. Further, the fact that such meeting minutes did not always exist should have set off "alarm bells" for KPMG.

The RCMP investigation of Royal Group Technologies' audit committee and external auditor illustrates how enhancing the quality of the audit process must be a key objective in Canada. A critical change in this regard is to eliminate potential conflicts of interest at public accounting firms. First, there must be prohibitions on the provision of certain non-audit services (such as consulting services) by a company's external auditor and requirements for audit partner rotation for public company auditors. Second, the auditing process may be compromised if the external auditors view their main responsibility as serving management rather than the shareholders. Therefore, it must be the role of a company's audit committee to manage the relationship between the company and the external auditor to ensure that the external audit is conducted independently of company management. This requires all Canadian public companies to have an audit committee that is fully independent and financially literate, which would be responsible for nominating the external auditor, pre-approving all non-audit services provided by the auditor, and reviewing all financial and other disclosures.

Enforcement Effectiveness

Canadian regulators have a responsibility to proactively enforce securities laws to protect investors and foster a fair and efficient marketplace. The following quotes illustrate a widespread belief that this responsibility is not being met:

- Wise Persons Committee:
  - "We believe that inadequate enforcement is one of the most significant weaknesses of the current system."
  - "There is a widely held view that enforcement in Canada is lax in comparison with the United States and other countries."

- Bank of Canada Governor David Dodge
  - Canada is a "Wild West up here in terms of the degree to which rules and regulations are enforced."

What do these opinions stem from? They are likely based on the many stagnant or long-dormant Canadian proceedings that are tantamount to no prosecution at all. It is shocking to examine the current state of investigations concerning certain former executives at Livent, Nortel and Royal Group Technologies, for example. Suspicions surrounding Livent surfaced in 1998 yet it took another 6 years for Canadian authorities to get the principal offenders into court on fraud charges. Turning to more recent fraud allegations, Royal Group Technologies is not even listed under the enforcement proceedings on the Ontario Securities Commission's website and the latest enforcement proceedings on Nortel involve a request for OSC exemption from the requirement to deliver its interim financial statements and annual financial statements. Concerns about the effectiveness of Canada's enforcement record also derive from high-profile cases such as Bre-X and YBM that have been subject to criminal law enforcement investigations and no one involved has yet gone to jail. Obviously, Canada does not lack for cases of financial dishonesty and market-related crime, but where are our tough jail sentences like those recently handed down to former executives of WorldCom, Tyco and Adelphia in the United States? There is clearly a problem on the prosecution side in Canada.

In addition to our inability to bring lawbreakers to jail, there are also some disturbing examples of delays between detection of a possible problem and action by regulators. A recent class-action suit filed in the Crocus Investment Fund affair alleges that the Manitoba Securities Commission "acted in a grossly careless and reckless manner" in its investigations of complaints regarding the valuation of the Crocus units. Last summer, allegations of financial misconduct/misappropriation of funds were levied at Norshield Financial Group, Portus Alternative Asset Management and Norbourg Asset Management. In all three cases, attempts apparently were made by members of the financial community to alert securities regulators in several provinces to serious disclosure problems. By the time regulators shut down the operations, the money was gone, relieving retail investors of millions of dollars. In the case of YBM, the OSC appears to have had information to raise suspicions about the information contained in the firm’s 1997 prospectus such that, as a precondition to receipting the prospectus at issue, the OSC requested that a "big 6" accounting firm conduct a high risk audit. The audit failed to disclose that the financial statements were a sham. As a result the OSC receipted the prospectus, the shares were issued and the shareholder losses followed. As bcIMC understands it, the OSC staff had suspicions about the accuracy of the prospectus YBM asked them to receipt but the staff believed, based on prior commission decisions, that they could not refuse to receipt the prospectus because they could not prove these suspicions on a balance of probabilities. Lacking the resources to investigate and obtain clear and convincing proof, the OSC felt obliged to receipt the prospectus in spite of its misgivings. These five examples of regulators’ failures to take meaningful action on allegations or suspicions of serious investor harm raise two important issues: First, that regulators require sufficient resources. And second, that consideration be given to placing the onus on the issuer to satisfy the regulator that its disclosure is sufficient to justify permitting it to issue securities to the public.

A much more aggressive investor protection system should include improvements in the processes for compensating shareholder losses. Currently, losses due to financial misrepresentation, negligence, conflict of interest or other frauds are mostly recouped by shareholders through the courts either individually or via class action. Securities commissions rarely apply to the courts for restitution or compensation orders, and should be encouraged to do so. This is a much less expensive and time-saving approach versus direct lawsuits or class action loss suits which can take years to settle and a significant portion of any payment is directed toward legal costs. In summary, securities regulators should place a greater emphasis on acting as a facilitator or catalyst in assisting investors in receiving compensation.

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Thank you for considering our comments. We look forward to the opportunity of privately addressing these issues in person on November 17th in Vancouver.

Sincerely,

Doug Pearce
Chief Executive Officer/Chief Investment Officer

Location: 3rd floor, 2940 Jutland Road, Victoria BC, V8T 5K6
Mailing Address: PO Box 9910, Stn Prov Govt, Victoria BC, V8W 9R1
Telephone (250): 356-0263 Facsimile: (250) 387-7874

December 19, 2005

BY E-MAIL

Mr. Tom Allen
Chair, IDA Task Force on Modernizing the CBCA
Suite 1600, 121 King Street West,
Toronto, Ontario M5H 3T9

Re: Follow-up to November 17 Meeting with the IDA Task Force

Dear Mr. Allen:

British Columbia Investment Management Corporation (bcIMC) appreciated the recent opportunity to personally express our views on how Canada's legislative and regulatory environment might be improved. I would very much have liked to participate in bcIMC's November 17, 2005 presentation to the IDA Task Force, but I had already committed to an investor tour in Asia when the date of the Vancouver meeting was announced. This letter is intended to follow-up on the comments and questions raised by Task Force members during the presentation.

I. Should directors be prohibited from owning shares in the company, because ownership conflicts with a duty to disclose bad news that might depress the value of the stock?

There is of course a risk that directors may, if they own shares, have an incentive to suppress bad news so as not to reduce the price of their stock. We believe this risk is small, especially compared to the risk that management will suppress bad news.

First, management always has an incentive to suppress bad news, especially if (as is usually the case) they are entitled to (a) bonuses related to performance and (b) stock awards related to performance.

Second, a director takes great risk in suppressing bad news since (a) all other directors will know about the bad news and its suppression, and (b) board processes usually ensure that there is some record that they were in possession of the bad news and chose not to disclose.

Third, as we noted during our presentation, bcIMC is specifically opposed to performance-based compensation for directors precisely because of the significant potential for misalignment of directors' interests with those of the long-term owners of the corporation.

II. Doesn't bcIMC's proposed prohibition on issuing shares with limited voting rights deny investors the right to buy into a company where the share structure ensures it will continue to be controlled by an individual with "a magic touch"

First, this would be a sensible question if investors could know for a certainty that the controlling individual had a magic touch and would always be honest. But of course in January 2000, investors thought Ken Lay was an honest man with a magic touch. And if it ever turns out that the individual with the magic touch is not competent or honest, a two-tier voting structure takes away the most logical means of removing him/her.

Second, as the Task Force suggests, the dual class share model allows companies to raise money without losing any control. In bcIMC's view, this provides insufficient justification for this practice. The original owners of a company can retain control by simply owning a majority of shares in the corporation, rather than creating a separate class of shares with multiple voting rights.

III. Why don't investors like bcIMC who are opposed to dual class share and voting structures simply choose not to invest in corporations with such structures?

Until recently, bcIMC had little choice whether or not to invest in a particular Canadian company. With the elimination of the foreign property rule, we now have a much broader investment universe, and can show our disapproval for subordinated voting structures by choosing not to invest in corporations with such mechanisms. We agree that the market has some role to play in directing the practices of corporations, however, the law should also be reformed to address this fundamental barrier to meaningful and equal shareholder rights.

IV. Since bcIMC supports imposing joint and several liability on those responsible for the preparation of corporate financial statements, would it be logical then to require directors to have a level of financial independence?

We are not suggesting that only rich persons will be able to be directors if they are made jointly and severally liable. For directors who act honestly and in good faith with a view to the best interests of the corporation, an enhanced personal liability regime poses no additional financial risk. For directors who act in bad faith or are negligent in their oversight of financial disclosures, joint and several liability places the proper burden of restitution and accountability upon them.

V. The Ontario Securities Act is being amended to provide for a "due diligence" defence that would apply to the deemed reliance in actions for misrepresentation for losses arising from the purchase of shares on the secondary market. Does bcIMC think that such a defence should also apply to the deemed reliance prescribed for prospectus purchases?

In our view the current defenses provided by s.130 (2) to (7) of the *Ontario Securities Act* reflect the appropriate balance of interests between investors and participants in the issuing of a prospectus. bcIMC does not believe that a due diligence defense should be available to a prospectus issuer.

VI. In bcIMC's view, would a transaction fee be an appropriate way to fund or increase funding for securities law enforcement?

We support the view that an efficient (and therefore honest) securities market benefits the economy as a whole, and that the costs for regulatory oversight and enforcement to achieve this efficiency should be spread over the economy as a whole.

bcIMC is adverse to the imposition of transaction fees for trades in securities in order to fund the resources necessary for securities regulators to improve oversight and enhance enforcement.

First, regulators are not reliably enforcing as it is. What assurance do we have that they would use more money for better enforcement?

Second, now that the foreign property rule has been abolished, Canadian investors like bcIMC have the flexibility to search out and participate in markets which are both well-regulated *and* have low transaction costs. We can invest where we like, and we will invest where the regulators act to ensure a fair market.

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Again, thank you for the opportunity to comment on Canadian securities and corporate law reform.

Sincerely,

Doug Pearce
Chief Executive Officer/Chief Investment Officer