ACC Annual Meeting 2011

Session 809: Canadian Securities Regulation – Keeping up with the SEC and Other Developments

Panel Members: David Kohlenberg, TransCanada PipeLines Limited
Tom Smee, RBC Financial Group
Andrew Thorpe, Morrison & Foerster LLP
Ed Waitzer, Stikeman Elliott LLP

Topics for Discussion	Materials
1. Private Securities Litigation • Recent developments • Convergence of markets	S. Rubin, *Milberg LLP Comes to Canada* Re: *Dugal v. Manulife Financial Corporation*
2. Requirements When "Bad Things" Happen • Whistle-blowing • Corrupt practices • Anti-bribery • Up-the-ladder reporting	P. Beaudry, *Canada's Corruption of Foreign Public Officials Act shows its teeth* J. Cox & S. Sagayam, *The employee strikes back* J. Cole & L. Lamb, *Out of the frying pan* R. Lindsay & A. Crockett, *Does money mind if we say it's evil?* Fishbein, Urofsky & Kelly, *The UK Bribery Act 2010* E. Waitzer, *Joining the global dialogue on corporate social responsibility* E. Waitzer, *Should we pay for whistle-blowing?* D. Lascaris and response by E. Waitzer, *Whistleblower debate: Speak truth to power*
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Milberg LLP Comes to Canada

by Sandra Rubin

Studies show that shareholder lawsuits in Canada are on the rise at a time when US courts are raising pleading standards and slashing punitive damages. And you know who's been paying attention to the burgeoning market to the north? Milberg LLP, the new incarnation of Milberg Weiss Bershad & Schulman LLP — the former Wall Street powerhouse that pioneered shareholder class actions, and, at one time, terrorized corporate America.

Won Kim; Kim Orr Barristers

In a strategy sure to generate buzz on both sides of the border, the new Milberg is about to become active in Canada.

"I've developed an appreciation that Canadian law has been getting as good as or better than US law at protecting investors' rights," says Michael Spencer, a class-action litigator and member of Milberg's executive committee. "So we been quietly monitoring the situation and we think there are some interesting prospects that have come up."

Spencer was in Toronto recently with Arthur Miller, head of the firm's appellate practice. They met with lawyers from K Orr Barristers P.C., a Toronto class-action boutique, and have quietly begun working together. Both confirm that they working on joint filings (and the first one should be coming soon), but say it's premature to go public with further detail

When pushed, all Spencer would say is "anyone looking at the markets and the things regulators are interested in woı be surprised at the things we are looking at. We are proceeding very cautiously because it's clear to us these are situations involving Canadian law and Canadian investors and Canadian courts."

Won Kim of Kim Orr says the presence of the dominant US class-action firm is a boon for Canadian shareholders whc the past, have too often come up empty-handed.

"Canadian investors haven't been particularly well served over the years when it comes to market misconduct," he sa "Bill 198 is a tool that can be used to change that and Milberg can help enormously in terms of experience and advice to mention resources and infrastructure. They've done these kinds of suits for decades.

"They're the pre-eminent securities firm in the United States. What they bring to the table is invaluable."

Miller is expected to play a role in shaping the firm's Canadian strategy — and he has credentials that would be impre in any jurisdiction. He wrote *Federal Practice and Procedure*, the principal authority on US federal practice, as well as *Procedure*, the casebook still used by most US law schools.

"I think Arthur's sterling reputation will convince Canadian judges and the Canadian Bar that we mean business," says Spencer, "but in a very respectable way."

Spencer stressed the firm sees Canada as a viable new market, and not a stalking horse that would allow it to gain ac to information in pre-certification discovery that could be used to further US suits.

"The things we're looking at are primarily Canadian cases, and I would expect the litigations would be in Canada," he "I don't think there will even be US cases over these things we're looking at."

Larry Lowenstein, head of the litigation department at Osler, Hoskin & Harcourt LLP, calls the arrival of Milberg in Car "an important development.

"It doesn't entirely surprise me because the Canadian securities-class litigation scene is much more active now, but I'ı little surprised at what they're saying about this not being just a matter of using the discovery processes to aid US acti

"If what they're saying is they can marry their expertise with a Canadian firm's personnel, that could be quite a credibl business plan."

Miller says Canada has made significant progress in the area of securities class actions and he praises Ontario's new regime for tamping down strike suits.

"I think Canadians have understood it's important to prevent the entrepreneurial instincts from creating too much of ar incentive to bring cases at the margins," he says from New York. "That's being done through better control over attorn fee awards, limitations on fee awards and limitations on damages. My sense is Ontario is avoiding some of the mistak made in the United States."

Miller says another important element key in Milberg's decision to become active in Canada is the Ontario Court of Appeal's decision in *Markson v. MBNA Canada Bank*. The appeal court judges held that statistical sampling can be u: to calculate a damage award — meaning proof of individual losses is not necessarily needed before a class action ca ahead.

"In some respects, Ontario's class-action law and some pieces of Ontario's securities law strike me as better vehicles protecting investors and having a more legitimate, reasonable, rational procedure than the existing situation in the Uni States," he says. "In some respects, Ontario has leapfrogged the United States."

Joel Rochon of Rochon Genova LLP, a Toronto-based class-action boutique, says given the corporate shenanigans c both sides of the border Canadians should embrace the expertise of US firms with strong experience in prosecuting securities cases. He says a key question is whether the Canadian defence Bar and courts will adequately recognize tl involvement of US firms when it comes to settlement agreements.

"In the past, their time has only been treated as a disbursement," says Rochon. "I query whether this somewhat protectionist approach needs to be re-examined by the courts to encourage positive collaboration."

Sandra Rubin is a freelance legal affairs writer.

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CITATION: *Dugal v. Manulife Financial Corporation,* 2011 ONSC 1785
COURT FILE NO.: CV-09-383998-00CP
DATE: 20110321

2011 ONSC 1785 (CanLII)

SUPERIOR COURT OF JUSTICE – ONTARIO

RE: **MARK DUGAL, IRONWORKERS ONTARIO PENSION FUND, et al.,** Plaintiffs/Moving Party

AND:

MANULIFE FINANCIAL CORPORATION, et al, Defendants/Respondents,

BEFORE: **G.R. Strathy J.**

COUNSEL: *Charles M. Wright, Michael D. Wright, Daniel Bach and Stephanie Dickson,* for the Plaintiffs/Moving Party

Patricia D.S. Jackson and Andrew Gray, for the Defendant/Respondent, Manulife Financial Corporation

R. Paul Steep and E.S. Block, for the Defendant, Peter Rubenovitch

Linda L. Fuerst, for the Defendant, Domenic D'Alessandro

Alexa Abiscott, for the Defendants, Gail Cook-Bennett and Arthur Sawchuk

HEARD: February 8, 2011

INTERIM REASONS

(Litigation Funding Agreement)

[1] The plaintiffs in this proposed class proceeding ask the court to approve a funding agreement, under which a third party will indemnify the plaintiffs against their exposure to the defendants' costs, in return for a seven percent (7%) share of the proceeds of any recovery in the litigation. That share is subject to an upper limit. The third party will also pay $50,000 towards the plaintiffs' disbursements.

[2] These interim reasons will explain why I have decided to approve the funding agreement, subject to changes being made to address two concerns identified below. I will release further reasons if, and when, those concerns have been addressed.

This Proceeding

[3] The plaintiffs claim that the defendant Manulife Financial Corporation ("Manulife"), which is a public company, made misrepresentations concerning its risk management practices in its public disclosure documents, and that this had the effect of artificially inflating the value of its stock. It alleges that when the truth became known, the value of the securities plummeted, resulting in damages to the plaintiffs and others who purchased Manulife's securities during the class period. This action has not yet been certified as a class proceeding under the *Class Proceedings Act, 1992*, S.O. 1992, c. 6 (the "*C.P.A.*").

The Funding Agreement

[4] The plaintiffs have entered into a funding agreement with Claims Funding International PLC ("CFI"), an Irish corporation, which will pay any adverse costs award made against the plaintiffs, in return for a "commission" on any settlement or judgment in this action.

[5] The funding agreement is subject to court approval. If approved, the agreement will be binding on both the plaintiffs and the class members.

[6] The following are the material terms of the funding agreement:

- CFI is entitled to a commission of 7% of the amount of any settlement or judgment, after deduction of the fees and disbursements of class counsel and administration expenses.
- The commission is subject to a "cap" of $5 million if the resolution occurs at any time prior to the filing of the plaintiffs' pre-trial conference brief and $10 million if the resolution occurs at any time thereafter.
- CFI will pay $50,000 towards the plaintiffs' disbursements.
- Class counsel are required to advise CFI of any significant issue in the proceeding, including prospects of success, strategy and quantum, and class counsel are required to respond to any reasonable request by CFI for information about the proceedings.
- CFI acknowledges that the representative plaintiffs are to instruct counsel and that counsel's duties are to the plaintiffs and not to CFI.
- The plaintiffs must conduct the proceeding in a manner that avoids unnecessary costs and delay and must provide full and honest instructions to class counsel.
- CFI is not required to provide funding for any appeal unless it independently decides to do so.

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- CFI is only entitled to terminate the agreement if the plaintiffs breach their obligations referred to above or appoint different lawyers to replace class counsel.
- The agreement is governed by the laws of Ontario and Canada and is subject to the exclusive jurisdiction of the Ontario courts.
- The agreement does not come into effect unless approved by the court.

[7] Prior to this motion, class counsel provided notice of the proposed funding agreement to a number of potential class members, advising them of the hearing and inviting their comments. The shares of Manulife were widely held by independent investment funds and pension funds. Notice was given to the 25 such funds that held the largest number of Manulife shares during the class period. These entities include well-known investment firms as well as substantial public investors including the Canada Pension Plan Investment Board, the Ontario Teachers' Pension Plan Board and OMERS Investment Group. Seven of the 25 funds are members of the Canadian Coalition for Good Governance. In addition, notice was given to 68 class members who have contacted class counsel to advise that they purchased Manulife shares during the class period. There was no opposition to the funding agreement from any of the persons notified.

The Defendants' Concerns

[8] The defendants have raised several concerns. First, they say that the agreement is, or may be, champertous and therefore unlawful under the *An Act respecting Champerty*, R.S.O. 1897, c. 327 (the "*Champerty Act*").[1] Second, they say that the agreement fails to provide any assurance that their costs will actually be paid if the plaintiffs lose the action. Third, they are concerned that the agreement does not provide adequate protection for confidential information obtained by plaintiffs' counsel.

[9] I will discuss these concerns below. First, I will address the question of the court's jurisdiction to approve this agreement.

Jurisdiction

[10] Section 12 of the *C.P.A.* gives the court broad jurisdiction to "make any order it considers appropriate respecting the conduct of a class proceeding to ensure its fair and expeditious determination and, for the purpose, may impose such terms on the parties as it considers appropriate." That jurisdiction can be exercised on the motion of a party and is not dependent on the action having been certified. Orders under s. 12 are frequently made prior to certification.

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[1] This must surely be the shortest statute on the books: "1. Champertors be they that move pleas and suits, or cause to be moved, either by their own procurement, or by others, and sue them at their proper costs, for to have part of the land in variance, or part of the gains. 2. All champertous agreements are forbidden, and invalid."

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[11] In addition, the court has jurisdiction under s. 97 of the *Courts of Justice Act*, R.S.O. 1990, c. C.43 to make a declaratory order. I am being asked to make such an order, declaring that the agreement is approved and is binding on class members.

[12] The question is this – in a class proceeding, can the court make an order binding the class before the proceeding has been certified and therefore before there <u>is</u> a class? In *Fantl v. Transamerica Life Canada* (2008), 60 C.P.C. (6th) 326, [2008] O.J. No. 1536 (S.C.J.), aff'd (2008), 66 C.P.C. (6th) 203, [2008] O.J. No. 4928 (Div Ct.), aff'd 2009 ONCA 377, 95 O.R. (3d) 767 ("*Fantl*"), Perell J. answered the question in the affirmative. He held, at para. 58, that "while the circumstance of the action being or not being certified may be a factor in how the Court exercises its jurisdiction, certification is not a pre-requisite to that jurisdiction." He held that the jurisdiction included the authority to make orders to protect putative class members as potential parties to the litigation, to supervise the procedural conduct of the defendant and to supervise the relationship between class counsel, the representative plaintiff and the class.

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[13] The issue came up in the only Ontario case to directly consider a third party funding agreement, namely the decision of Leitch J. (now R.S.J.), in *Metzler Investment GMBH v. Gildan Activewear Inc.* (2009), 81 C.P.C. (6th) 384, [2009] O.J. No. 3315 (S.C.J.)("*Metzler Investment*"). That case also involved a proposed funding agreement by CFI.[2]

[14] In that case, submissions were made by the defendants, who successfully opposed approval of the funding agreement, that there was no jurisdiction under s. 12 of the *C.P.A.* to make a binding determination of the rights of class members prior to certification. Leitch J. was referred to Justice Perell's decision in *Fantl* as well as the decision of Cumming J. in *CC&L Dedicated Enterprise Fund (Trustee of) v. Fisherman* (2001), 6 C.P.C. (5th) 281, [2001] O.J. No. 637 at paras. 40-41 (S.C.J.), leave to appeal denied (2001), 55 O.R. (3d) 794, [2001] O.J. No. 3727 (C.A.). She concluded that, although the court had broad discretion under s. 12 of the *C.P.A.*, that discretion should not be exercised when the action had not yet been certified and class members had not had an opportunity to present their views. She then went on to consider whether the agreement should be approved simply as a private contract between the plaintiff and the funder and, for reasons discussed below, concluded that it should not.

[15] In this case, the plaintiffs have sought to address the concern raised by Leitch J. by giving notice of the agreement to a representative cross-section of class members.

[16] In this case, I am being asked to approve an agreement made between the representative plaintiff and a third party. That agreement has implications for the defendants, for proposed class

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[2] I do not propose to discuss, in this interim endorsement, the entire history of the *Metzler* case, including the subsequent motion before Leitch J. to approve an amended agreement (December 2, 2009, unreported) or the decision of Little J. granting leave to appeal that decision: *Metzler v. Gildan*, 2010 ONSC 1486 (Div. Ct.). Little J. expressed the view that there was good reason to doubt the conclusion of Leitch J. that third party funding agreements are not champertous *per se*. The appeal was not pursued.

counsel and for potential class members. It is an agreement that could affect the integrity of the litigation process and the due administration of justice. I am satisfied that I have jurisdiction to approve the agreement as part of the court's inherent jurisdiction to control its process. The question is whether I should exercise that jurisdiction at this time.

[17] While I recognize that the views of class members are important and deserve consideration in appropriate cases, a part of the court's responsibility in class actions is to protect the rights of prospective class members. One of the most important of those rights is the right to advance a class proceeding. To postpone the decision to post-certification, when the views of class members can be sought, could very well spell the end of this proceeding, because the plaintiffs cannot withstand an adverse costs award on certification. In my view, exercising the Court's supervisory jurisdiction over the proceeding, I am entitled to put myself in the shoes of prospective class members and ask whether the proposed agreement is fair and reasonable. For the reasons that follow, I find it is. The fact that it is acceptable to a reasonably representative and informed group of prospective class members is by no means determinative, but it is an important factor I have considered in coming to this conclusion.

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Is the Agreement Champertous?

[18] It is argued that such funding agreements are contrary to public policy and offend the law of champerty and maintenance – a body of law that was designed to protect the administration of justice from abuse by the exploitation of vulnerable litigants. In *McIntyre Estate v. Ontario (Attorney General)* (2002), 61 O.R. (3d) 257, [2002] O.J. No. 3417 (C.A.) ("*McIntyre Estate*"), the Court of Appeal held that a lawyer's contingent fee agreement was not *per se* prohibited by the *Champerty Act* and that it was necessary for the court to consider the reasonableness and fairness of the fee structure in the contingency fee agreement. The fee in that case was based on a percentage of the damages recovered, with no cap or upper limit on the amount that might be payable. The court therefore concluded that it was premature to determine whether the agreement was reasonable and fair because the fee payable might prove to be unreasonable when considering the factors that courts historically take into account in fixing lawyers' fees. The Court of Appeal held, at para. 79, that "[w]hen an agreement like this one is structured so that the fees are based on a percentage of the recovery, the determination of whether the fees are reasonable and fair will normally have to await the outcome of the litigation."

[19] In *Metzler Investment*, Leitch J. concluded that a funding agreement will be champertous if it is "spurred by some improper motive" and that the nature and amount of the fees to be paid are critical in determining whether the motivation was improper. She concluded, following the approach of the Court of Appeal in *McIntyre Estate*, that in the case before her it was too early to conclude that the agreement was reasonable.

[20] Following the *ratio* in *McIntyre Estate*, it would appear that exacting an unfair price for the funding agreement, with resulting unfairness to the litigant, would be an improper motive.

Funding Agreements in other Jurisdictions

[21] I have been informed by plaintiff's counsel of two recent cases in which funding agreements were approved by Canadian Judges. In *Hobshawn v. Atco Gas and Pipelines Ltd.* (May 14, 2009), Action 0101-04999 (Alta. Q.B.), Justice Lovecchio of the Alberta Court of Queen's Bench approved a third party indemnification agreement on an *ex parte* application. No reasons were given. The funder was Bridgepoint Financial Services Partnership III.

[22] In *MacQueen v. Sydney Steel Corporation* (October 19, 2010), Action 218010,(N.S.S.C.), Justice John D. Murphy of the Supreme Court of Nova Scotia approved a funding agreement between the representative plaintiffs and Bridgepoint Financial Services Limited Partnership IV. Again, no reasons were given.

[23] In the absence of reasons in either of these cases, it is difficult to come to any conclusion except that an appropriate form of funding agreement has been permitted in other provinces.

[24] Funding agreements have been approved in England and Australia: *Arkin v. Borchard Lines Ltd. And Others*, [2005] 1 W.L.R. 3055 (C.A.); *Campbells Cash and Carry Pty Ltd.*, 229 C.L.R. 386, (Aus. H.C.); *QOSX Ltd. v. Ericksson Australia Pty. Ltd. (No. 3)*, [2005] F.C.A. 933 (Aus. F.C.); see also R. Mulheron and P. Cashman, "Third Party Funding: A Changing Landscape" (2008) 27 C.J.Q. 312.

[25] The situation in Australia is different than in Ontario because the *Legal Profession Act 2004* (Vic.) does not permit lawyers' contingency fees. However, a third party funder may negotiate an agreement to pay legal fees in addition to insuring against an adverse costs award, in return for a share in the proceeds.

Some Practical Concerns

[26] I will briefly mention some practical concerns.

[27] One of the important goals of class proceedings is to provide access to justice to large groups of people who have claims that cannot be economically pursued individually. In Ontario, the costs rules applicable to ordinary actions apply to class proceedings – ~~the loser pays.~~ The costs of losing can be astronomical – well beyond the reach of all but the powerful and very wealthy – not exactly the group the legislature had in mind when the *C.P.A.* was enacted.

[28] The grim reality is that no person in their right mind would accept the role of representative plaintiff if he or she were at risk of losing everything they own. No one, no matter how altruistic, would risk such a loss over a modest claim. Indeed, no rational person would risk an adverse costs award of several million dollars to recover several thousand dollars or even several tens of thousand dollars.

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[29] There have been two responses to this reality. First, it is quite apparent to judges case managing class actions in Ontario that indemnities given by class counsel are commonplace – they have been recognized as "part of the landscape in class proceedings": *Holmes v. London Life Insurance Co.* (2007), 40 CPC (6th) 167, [2007] O.J. No. 158 at para. 2 (S.C.J.); *Bellaire v. Daya* (2007), 49 C.P.C. (6th) 110, [2007] O.J. No. 4819 at para. 81 (S.C.J.). Such agreements impose onerous financial burdens on counsel and risk compromising the independence of counsel, which is such a valued part of our legal tradition.

[30] Second, financial support for disbursements, and indemnity against costs, may be provided by the Class Proceedings Fund (the "Fund") under the administration of the Class Proceedings Committee (the "CPC"). A defendant is entitled to make direct application to the Law Foundation for payment of any costs award.

[31] The Fund was established by the *Law Society Amendment Act (Class Proceedings Funding), 1992*, S.O. 1992, c. 7. The Fund was given initial seed money in the form of a $500,000 grant from the Law Foundation of Ontario. The CPC receives a levy in the amount of 10% on any awards or settlements in funded proceedings, together with repayment of any funded disbursements. Its annual report indicates that from its inception to June 2010 it had awarded funding to class proceedings in the amount of $6.8 million, it had paid costs awards in favour of defendants in the amount of $1.9 million and it had received $18.6 million in revenues from its entitlement to 10% of settlements or judgments. At June 30, 2010 its account stood at a balance of $11.3 million. From 1992 until June 30, 2010 the CPC received 96 applications for funding. Of those applications, 52 had been approved for funding, 28 had been denied or deferred and 16 had been withdrawn or are currently in abeyance.

[32] If class counsel is not prepared to accept the risk of an adverse costs award, then the plaintiff's only option is to either abandon the claim or apply to the Fund. The fund may or may not accept the application. If it accepts the application, its fee is an inflexible 10% of the recovery.

Reasons for Approving Agreement

Key Reasons

[33] In this case, subject to the concerns expressed below, I have decided to approve the funding agreement for the following reasons:

#1

(a) The funding agreement helps to promote one of the important goals of the *CPA* – providing access to justice. That goal would be illusory if access to justice were deterred by the prospect of a crushing costs award to be borne by the representative plaintiff or counsel. In this sense, the agreement is beneficial to the proper administration of justice: see *McIntyre Estate*, above, at para. 47. Just as contingency fee agreements have been recognized as providing access to justice, so too third party indemnity agreements can avoid the unfortunate result that

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individuals with potentially meritorious claims cannot bring them because they are unable to withstand the risk of loss: see *McIntyre Estate* at para. 55.

(b) There is no evidence that CFI stirred up, incited or provoked this litigation, within the meaning of the term "moved" in s. 1 of the *Champerty Act*: see *McIntyre Estate* at para. 41. On the contrary, the plaintiffs demonstrated a clear intention to proceed with this litigation before CFI came on the scene.

(c) The indemnification agreement leaves control of the litigation in the hands of the representative plaintiff – it does not permit officious intermeddling in the conduct of the litigation by the funder, but allows it to receive appropriate information about the progress of the litigation, consistent with its need to manage its own financial affairs, such as posting reserves.

(d) The commission payable (7%) is, in general, reasonable and consistent with the commission (10%) that would be payable to the only other available source, the Fund.

(e) The commission cap ($5 million prior to pre-trial and $10 million thereafter) is also reasonable and is a fair reflection of the potential downside risk facing the funder ($10 million in costs). In fact, in the event of a substantial recovery after trial, it is quite possible that the commission payable to CFI would be substantially less than the commission that would be payable to the Fund in similar circumstances.

(f) The commission is acceptable to the representative plaintiffs, both of who can be fairly described as sophisticated investors and, in the case of the Ironworkers Pension Fund, a sophisticated institutional investor. It is also acceptable to a large and reasonably representative cross-section of class members.

(g) While it is true that one may not be able to say, with absolute certainty, that there is no possibility that the funding agreement might result in a "windfall" recovery to CFI, the possibility of such a recovery, when balanced against the probability of protracted litigation and a somewhat speculative result, is a factor that a commercial risk-taker must take into account in determining the amount of its compensation. The assessment of the risk can always be defined with greater precision when more information is available, but the fact of the matter is that the plaintiff asks for a decision now. When an insurer sets a life insurance premium, it does not say to the assured, "We'll wait and see how you are doing in a couple of years." It fixes the premium based on the current state of knowledge, recognizing that the applicant may die the next day or live to be 101.

(h) In the existing state of affairs, in which the defendants profess every intention of mounting an aggressive and expensive defence, it is my assessment that the

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financial terms of the indemnification agreement are a fair reflection of risk and reward.

(i) The plaintiffs are represented by experienced and highly reputable counsel who can be expected to discharge their duties to the plaintiffs, the class and the court without being influenced by the funder.

(j) There will be court supervision of the parties to the agreement.

Remaining Concerns

[34] I do acknowledge two areas of concern raised by the defendants and I will require further evidence, and if the parties are unable to agree, further submissions, before approving the agreement.

[35] First, CFI has no assets in Canada and has provided no evidence concerning its capacity to satisfy any costs award that may be made. In these circumstances, I will not approve the agreement without adequate security being provided. I will also consider whether the defendants should be given a direct right against the security.

[36] Second, I agree with the defendants' submission that there should be some reasonable controls on the provision of information to the funder. The management of the funder's own affairs requires that it be provided with reasonable information concerning class counsel's assessment of liability, damages and trial prospects. It is also reasonable that information be provided concerning settlement offers. Appropriate guidelines need to be established to recognize the interests of both CFI and the defendants.

Conclusion

[37] For these reasons, subject to satisfactory amendments to address the concerns raised above and further submissions if necessary, I am prepared to approve the funding agreement.

G.R. Strathy J.

Date: March 21, 2011

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STIKEMAN ELLIOTT

Canadian Securities Law

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Posted at 10:53 AM on August 10, 2011 by Stikeman Elliott LLP

Canada's Corruption of Foreign Public Officials Act shows its teeth

Paul Beaudry -

On June 24, 2011, Niko Resources Ltd., a Calgary-based oil and gas exploration and production company, entered a guilty plea under Canada's ***Corruption of Foreign Public Officials Act*** (CFPOA) with respect to charges of bribing a public official in Bangladesh. Niko, which operates in a number of countries around the world, had been notified by Canadian authorities in January 2009 that it was being investigated over allegations that it had provided the Energy Minister of Bangladesh with a $190,000 vehicle for personal use as well as with trips to Calgary and New York. These gifts had been made at the time when the Minister was assessing how much compensation was owed to Bangladeshi villagers for water contamination and other environmental concerns caused by explosions at a Niko operation.

Niko's sentence included a $9.5 million fine and a three-year probation order that requires the company to implement a detailed compliance program subject to review by an independent auditor. Prior to Niko's conviction, only one Canadian company had been convicted of foreign bribery under the CFPOA in the past decade. The $25,000 fine issued by the court in that case, known as *R.* v. *Hydro Kleen Services Inc.*, was less than the bribe involved.

The Niko prosecution is a signal that Canada is serious about ramping up enforcement of the CFPOA. The guilty plea comes shortly after Canada was criticized by two international organizations for ineffective enforcement of anti-bribery legislation. In May 2011, Transparency International, a group that monitors global corruption, issued a report that criticized Canada for failing to enforce its foreign bribery laws, noting that the Canadian legal system and courts "do not handle complex 'white collar' criminal cases very well." This followed a similar report by the OECD Working Group on Bribery, published in March 2011, which found that "Canada's regime for enforcement of the *Corruption of Foreign Public Officials Act* remains problematic in important areas."

Canada's foreign bribery legislation

The CFPOA was enacted in 1999 and brought Canada into compliance with the 1997 ***OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions***.

The CFPOA prohibits giving or offering to give a benefit of any kind to a foreign public official, or any other person for the benefit of the foreign public official, where the ultimate purpose is to obtain or retain a business advantage. It is applicable both to individuals and corporations, whether acting directly or through an agent or third party. An individual need not be Canadian to be charged. The extraterritorial reach of the CFPOA means that a Canadian business could be liable in Canada and elsewhere: double jeopardy does not apply.

Violation of the CFPOA is an extraditable offense punishable, in the case of an individual, by imprisonment for up to 5 years. A company can receive an unlimited fine for failing to prevent bribery. There is no limitation period for indictable offenses. Because sanctions under the CFPOA are solely criminal, proof "beyond a reasonable doubt" is required.

Unlike parallel enactments in most other OECD countries, whose jurisdiction is based on the nationality of the accused, the CFPOA only applies when the bribery has a "real and substantial" connection to Canada (i.e., presence, action or effect in Canada). However, the involvement of a Canadian parent or subsidiary may be sufficient to trigger its application. In 2009, the Minister of Justice introduced legislation (Bill C-31) that would have added provisions to the CFPOA based on the nationality principle so that, in certain cases, offences committed outside Canada would be deemed to have been committed in Canada. However, it died on the order paper with the prorogation of Parliament in December 2010 and has not since been reintroduced.

Anti-Bribery in the United States and the United Kingdom

The United States (*Foreign Corrupt Practices Act*) and the United Kingdom (***Bribery Act***) also have legislation that prohibits the bribery of public officials and makes it a crime at home to bribe foreign officials or fail to maintain appropriate accounting records that would reveal such corruption. Canadian and American anti-bribery offenses are similar, making compliance less complex for corporations that fall within both jurisdictions. The UK's *Bribery Act*, enacted on July 1, 2011, is in some respects

stricter than its Canadian and U.S. equivalents. For example, rather than dealing only with bribery of government officials, the *Bribery Act* also covers corruption between commercial entities.

The limited number of convictions under Canada's anti-bribery legislation contrasts with the situation in the United States, which has dramatically increased its enforcement in recent years. Significant fines – frequently in excess of US$100 million and ranging as high as US$800 million – have been levied on companies under the *Foreign Corrupt Practices Act*.

Canada's *Corruption of Foreign Public Officials Act*: No Longer a Paper Tiger

The Niko case indicates that Canada is stepping up its enforcement of the CFPOA. The RCMP has indicated that its International Anti-Corruption Unit, established in 2008 with offices in Ottawa and Calgary, is currently conducting over 20 investigations of Canadian companies allegedly involved in overseas bribery. There is also a pending case involving an individual accused of bribing an Indian government official in connection with a contract for the supply of a security system.

In light of the above, Canadian companies with business activities overseas (especially in countries with high levels of corruption) would be well advised to review their processes and to implement adequate corporate compliance programs, which should include the following key elements:

1. proportionate procedures, including regular and comprehensive auditing, as well procedures for the reporting of potential violations;
2. top-level commitment: identification of an authoritative officer within the company who is responsible and accountable for anti-bribery compliance;
3. risk assessment of business projects involving business with other countries;
4. extensive due diligence of business projects involving business with other countries;
5. communication strategy (including training programs for employees and officers); and
6. monitoring and review of relationships with foreign government and business partners to establish and document compliance with anti-bribery legislation.

For more information concerning the *Corruption of Foreign Public Officials Act*, and what you should do to ensure your company is not caught unawares, please get in touch with your usual contact at Stikeman Elliott, or with the author.

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The employee strikes back

Recent US amendments, combined with longstanding UK protections, will lead to more whistleblower activity

On May 25 2011, in a 3-2 vote, the US Securities and Exchange Commission (SEC) approved its final rules (US rules) to implement the whistleblower award program of Section 21F of the Securities Exchange Act of 1934, which was added by Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

The US rules establish the standards and procedures the SEC will apply in awarding whistleblowers monetary compensation for providing tips about possible securities law violations (including violations of the Foreign Corrupt Practices Act) that lead to successful SEC enforcement actions and make definitions which set the contours for protections of whistleblowers under the Dodd-Frank Act's anti-retaliation provisions.

Under the US rules, a whistleblower who voluntarily provides the SEC with original information that leads to a successful enforcement by the SEC that results in monetary sanctions of more than $1 million arising out of the same core facts is eligible for an award of 10 to 30% of any amounts recovered.

As a result, there is little doubt that there will be an increase in external whistleblower activity. Indeed, the SEC has said that it expects to receive approximately 30,000 tips per year and plaintiffs' law firms have set up websites to attract whistleblower leads in the US and abroad.

"There is little doubt that there will be an increase in external whistleblower activity"

The Dodd-Frank Act significantly expands the protections afforded to whistleblowers under the Sarbanes-Oxley Act of 2002 (Sox) by increasing the scope of companies subject to the Sox anti-retaliation provisions, providing whistleblowers more time to make retaliation claims and increasing the penalties for such retaliation.

These laws, which apply in the context of securities law violations, supplement numerous existing US whistleblower laws designed to protect whistleblowers in a variety of other specific contexts, including workplace health and safety, environmental protection, energy, transportation safety, and taxation.

Another important law in the US whistleblower landscape is the False Claims Act (FCA), which imposes liability on persons and companies (typically government contractors) who defraud governmental programs. The law includes a *qui tam* provision that allows people who are not affiliated with the government to blow the whistle by filing actions on behalf of the government.

Whistleblowers in the UK have enjoyed protection against dismissal and retaliation since 1999 when the Public Interest Disclosure Act 1998 (PIDA) came into force, inserting new protections into the Employment Rights Act 1996 (ERA).

UK law protects employees and workers against retaliation for making a protected disclosure (of which more below).

Protection against retaliation

For the purposes of the anti-retaliation protections under the Dodd-Frank Act, an individual is a whistleblower if that individual possesses a reasonable belief that the information he or she is providing relates to a possible securities law violation that has occurred, is ongoing, or is about to occur, and he or she reports that information in accordance with the procedures delineated in the rules.

Protection from retaliation is only afforded to employees, but other classes of whistleblower may be eligible to receive an award under the whistleblower award program.

The original anti-retaliation provisions of Sox extended only to employees of publicly traded companies, but the Dodd-Frank Act has amended those provisions to include employees of subsidiaries or affiliates of publicly traded companies. Eligibility for protection from retaliation under other US laws varies depending on the applicable law, but protection is typically afforded only to employees under these laws.

In the UK, PIDA only affords protection to employees and other categories of worker.

Under normal circumstances, an employee may only claim unfair dismissal if he or she has the necessary period of qualifying service (currently one year) and any compensation will be subject to a maximum statutory cap (currently between approximately £68,000 and £80,000 depending on length of qualifying service).

However, employees who are dismissed for making a protected disclosure may claim unfair dismissal without any requirement to establish qualifying service. Furthermore, in such cases, compensation for unfair dismissal will be awarded without applying the statutory cap on compensation which usually applies in cases of unfair dismissal.

Workers, comprising not only employees but also other certain self-employed contractors, home workers and agency workers, also enjoy protection against retaliation should they make a protected disclosure and also stand to recover appropriate compensation including damages for injuries to feelings and aggravated damages in appropriate cases.

When is an eligible whistleblower protected?

The protection provided under the US rules is available to persons with information concerning a possible securities law violation.

Similarly, Sox prohibits companies from engaging in retaliation against an employee for providing information regarding conduct the employee reasonably believes constitutes a violation of any rule or regulation of the SEC, federal criminal provisions relating to securities, bank, mail, or wire fraud, or any federal law relating to fraud against shareholders.

A patchwork of other federal and state laws protects whistleblowers from retaliation in various other specific contexts.

By contrast, the UK protects whistleblowers pursuant to one act, PIDA (whose provisions are now contained in the ERA), which makes protections available to

employees and workers with information concerning which they reasonably believe falls into one or more of the following categories: (i) a criminal offence; (ii) a breach of any legal obligation; (iii) a miscarriages of justice; (iv) dangers to health and safety of any individual; (v) damage to the environment; and (vi) the deliberate concealing of any of the above.

Somewhat surprisingly, the UK courts have made it clear that there need be no public interest in the information being disclosed. An employee can therefore claim protection when disclosing information concerning a breach of his or her own employment contract.

Qualifying for protection

In order to qualify for protection against retaliation under the US rules, a whistleblower must possess a reasonable belief that the information he or she is providing relates to a possible securities law violation that has occurred, is ongoing, or is about to occur, and he or she reports that information in accordance with the procedures delineated in the rules.

"To be eligible for an award, the whistleblower must provide information voluntarily to the SEC"

In order to qualify for protection under the UK regime, the worker or employee must disclose information concerning a matter which qualifies for protection (see above) to their lawyer for the purposes of obtaining advice or in good faith to their employer or another person prescribed the legislation.

Disclosures to prescribed persons such as the Financial Services Authority or Her Majesty's Revenue & Customs are protected where the whistleblower reasonably believes that: (i) the default in question falls within the remit of that body; and (ii) the information disclosed and any allegation within it is substantially true. Wider disclosure (for example to the police or media) is only protected if a stringent list of criteria are satisfied.

Eligibility for financial award

The US rules provide a potentially significant financial incentive to persons in possession of information concerning possible violations of federal securities laws to blow the whistle to the SEC.

The US rules define a whistleblower as an individual who, alone or jointly with others, "provides the SEC with information . . . [that] relates to a possible violation of the federal securities laws (including any rules or regulations thereunder) that has occurred, is ongoing, or is about to occur".

A whistleblower may remain anonymous when reporting possible violations to the SEC, but, to do so, must report through an attorney.

The US rules exclude a number of categories of whistleblower from eligibility for an award. The following are examples of categories of individuals who, subject to certain exceptions, are ineligible to receive an award: (i) principals (officers, directors, trustees, or partners of a company who receives information about the alleged misconduct from a company employee or from the company's internal compliance process); (ii) attorneys and information obtained in connection with legal representation; (iii) compliance personnel; (iv) individuals retained to conduct an inquiry; (v) accountants; (vi) those who have obtained information by means judged to be illegal by a US court; and (vii) foreign government officials.

Under certain circumstances, the US rules provide exceptions for excluded individuals who are principals, compliance or internal audit personnel, individuals employed by or otherwise associated with a firm retained to conduct an inquiry or investigation into possible violations of law, or independent public accountants.

An otherwise excluded whistleblower belonging to one of these categories will be eligible for an award if he or she has a reasonable basis to believe that disclosure is necessary to prevent the company from engaging in conduct that is likely to cause substantial financial injury to the company or investors belonging to one of these categories.

A whistleblower is also eligible if he or she has a reasonable basis to believe the company is engaging in conduct that will impede an investigation of the misconduct, or at least 120 days have elapsed since the whistleblower provided the information through the company's internal reporting system.

Eligibility of information

In order to be eligible for an award, the whistleblower must provide information voluntarily to the SEC; that is, before a request, inquiry, or demand was directed to the whistleblower personally or to his or her representative by the authorities and in circumstances where the whistleblower is not under a pre-existing legal duty to report.

All information provided must be original, being based on the whistleblower's independent knowledge or independent analysis, and must not already be known to the SEC.

If the whistleblower provides the same information to an internal compliance program, the whistleblower will have a 120-day time period during which he or she can alert the SEC and still be considered to have provided original information as of the date the information was provided to the internal compliance program.

A whistleblower provides original information that leads to a successful enforcement action in several situations: first, when the information was sufficiently specific, credible, and timely to cause the staff to commence an examination or open an investigation; and second, the information may lead the staff to reopen an investigation, or inquire concerning different conduct as part of a current examination or investigation.

In both instances, an award may be made if the SEC brings a successful judicial or administrative action based on that information. In contrast, when an examination or investigation was already underway, and the whistleblower's submission significantly contributed to the success of the action, then the whistleblower also may be eligible for an award.

In addition, a whistleblower will be eligible for an award if he or she reports original information through a company's internal legal or compliance reporting procedures before or at the same time it is reported to the SEC and the company then reports the information to the SEC. Further, the SEC may attribute all the information provided by the company to the SEC to the whistleblower, whether or not originally reported by the whistleblower.

As a result, a whistleblower may get credit—and potentially a larger award—for any additional information that is generated by the company in its investigation. This is intended to provide additional incentives for whistleblowers to report internally.

The $1 million threshold can be met by civil money penalties, disgorgement payments, and prejudgment interest totaling more than $1 million whether from a single or multiple cases that arise out of the same nucleus of operative facts as a

single action, as well as related actions brought by other government agencies such as criminal prosecutions by the Department of Justice.

The SEC will not pay an award if an award already has been granted to the whistleblower by the US Commodity Futures Trading Commission for the same action.

Factors impacting amount of award

The US rules give the SEC wide discretion in determining the amount of the award within the 10% minimum and the 30% maximum provided in the statute. In determining the amount of an award, the SEC will consider:

- the significance of the information provided by a whistleblower to the success of the SEC action or related action;
- the degree of assistance provided by the whistleblower and any legal representatives of the whistleblower;
- the interest of the SEC in deterring violations of the securities laws by making awards to whistleblowers who provide information that leads to the successful enforcement of such laws; and
- whether the whistleblower participated in internal compliance systems and reported any violation internally, or assisted in any internal investigation.

"In the UK. PIDA does not provide any financial incentive for an employee or worker to blow the whistle"

The SEC also will consider the personal culpability of the whistleblower (that the whistleblower may have been to blame does not exclude the potential to receive an award in all cases), any unreasonable delay by the whistleblower in reporting the securities violations and whether the whistleblower interfered with internal compliance and reporting systems.

In the UK, PIDA does not provide any financial incentive for an employee or worker to blow the whistle, although those who do and are subsequently dismissed (in the case of employees) or subject to retaliation (in the case of workers) may recover significant compensation.

While any award compensation will focus upon compensating the employee for loss suffered as a consequence of dismissal or retaliation, damages may also be awarded for injuries to feelings and, in appropriate cases, aggravated damages may also be awarded.

In addition, certain public authorities such as the Office of Fair Trading and Her Majesty's Revenue & Customs offer rewards for information received concerning cartels (in the case of the former) and smuggling and certain other tax evasion (in the case of the latter).

The US rules provide a strong financial incentive for employees in possession of information about possible violation of securities laws to disclose that information the SEC. While the US rules do not discourage whistleblowers to report matters internally before going to the SEC, neither do they require them to do so.

In contrast, PIDA can be said to encourage internal reporting in that it restricts the circumstances in which disclosures made to persons outside the company will be protected.

Are whistleblowers who go to the media protected?

A recently decided US case ruled that the whistleblower provisions of Sox do not protect employees who disclose information to the media. However, courts have determined that other whistleblower protection laws, such as the Whistleblower Protection Act, which protects government employees from retaliation, protect whistleblowers who expose wrongdoing to members of the press.

The Dodd-Frank Act does not expressly address whether the whistleblower protections afforded by it will protect individuals who disclose information to the media.

Under the UK regime, a disclosure of relevant information to the media will only be protected if: (i) that disclosure is made in good faith; (ii) the worker reasonably believes that the information disclosed and any allegation within it is substantially true; (iii) the disclosure is not made for personal gain; and (iv) the worker has either: (a) previously disclosed the information to the employer or a prescribed person; or (b) reasonably believes either that they will be subject to a detriment or that material evidence will be concealed or destroyed if they do so.

Can a UK employee claim protection under the US rules?

The provisions of the Dodd-Frank Act and the US rules that define who is eligible to receive a whistleblower award or to be protected by the new anti-retaliation provisions do not require an individual to be a US citizen or located in the US. Consequently, some observers predict the lucrative incentives of the whistleblower award program will generate an influx of complaints relating to alleged violations of the Foreign Corrupt Practices Act.

In contrast, at least one US court has held that the whistleblower protections afforded by Sox do not extend to foreign workers employed by foreign subsidiaries of US companies. While the Dodd-Frank Act specifically amends the Sox anti-relation provisions to include subsidiaries and affiliates of US companies, it does not expressly address whether these protections apply to foreign subsidiaries or affiliates of such companies.

While the UK and US regimes differ in a number of important respects, they both operate to provide a strong incentive upon companies to promote a compliance culture and put in place appropriate policies and procedures (including internal reporting procedures) which demonstrate their commitment to compliance and encourage compliance in their employees, customers and suppliers by the use of appropriate incentives and penalties.

It remains to be seen whether the potentially significant awards available under the US rules are made available to non-US citizens located outside the US.

By partners James A Cox and Selina S Sagayam, and associate Michael A Titera of Gibson, Dunn & Crutcher

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Whistleblower rules incentivise internal reporting - p.19

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Out of the frying pan

The UK's new Bribery Act will have a big impact on businesses worldwide. But corporates must not ignore their obligations under existing anti-money laundering laws

After much fanfare and debate, the Bribery Act 2010 finally came into force on July 1 2011. Anyone who does business in the UK is likely to have spent a lot of time over recent months preparing for the introduction of one of the most hotly anticipated pieces of legislation to hit the statute books in some time; but is this really the biggest risk?

A considerable amount has been written about the Act's likely impact and there is no doubt that it will be an important weapon in the armoury of the Serious Fraud Office (SFO). However, it is not the only tool available to prosecutors in their fight against bribery and corruption; nor is it the most ferocious. Very little has been said about the existing body of anti-money laundering laws which already place onerous obligations on individuals and businesses throughout the UK.

Ignoring those laws in a bribery and corruption context would be a dangerous mistake. With their confiscation and civil recovery remedies, harsh penalties and reporting obligations, they will prove to be a very powerful weapon in the hands of the prosecutors.

The Bribery Act

The jurisdictional scope of the Bribery Act is unprecedented. It applies not only to UK companies and individuals, but also to any foreign company which does business in the UK. It establishes two general offences of bribery: one of offering, promising or giving a bribe and one of requesting, agreeing to or receiving a bribe. There is also a separate offence of bribing a foreign public official. But perhaps the most significant (and most talked about) offence is the new corporate offence of failing to prevent bribery.

This makes companies criminally liable for acts of bribery committed by their "associated persons" (those individuals and entities that provide services for or on behalf of the corporate which could include employees, agents, subsidiaries, joint venture partners, suppliers and contractors). Even more radical is the fact that a prosecutor does not need to prove knowledge or fault on the part of the corporate – it is in essence a strict liability offence.

Commercial organisations will only be able to avoid liability if they can prove that they had "adequate procedures" in place to prevent bribery (in other words that the event was a one-off rather than the result of institutional failures). So far, so straightforward, at least so far as the Bribery Act is concerned. But that is only a part of the picture, and not necessarily the trickiest part.

Anti-money laundering laws

The SFO is well aware of the use that it can make of anti-money laundering laws. In recent speeches, SFO director Richard Alderman has said that, while the SFO has focused on corruption charges in the past, he expects to see far more use being made of anti-money laundering laws in the fight against corruption:

"I expect us to follow the money against a range of individuals and organisations so that all of those involved in corruption and the laundering of corrupt monies are dealt with by prosecution or through some other way. It seems to me that there is a very great deal of potential in this area."

This is not just an idle threat. The SFO has used the provisions of the Proceeds of Crime Act 2002 (POCA) very successfully for a number of years to obtain confiscation and civil recovery orders following allegations of corruption. Both are mechanisms which will enable law enforcement authorities to recover the proceeds of or benefit derived from unlawful conduct (including, for example, profits generated by contracts obtained through corruption) – alongside the imposition of criminal sanctions under the Bribery Act.

POCA's confiscation and civil recovery provisions are not the only aspects of which businesses need to be aware. They also need to understand the risks under Part 7, which provides that a person commits an offence if he conceals, disguises, transfers, converts, acquires, uses, has possession of or removes from the UK any criminal property. A person also commits an offence by entering into or becoming concerned in an arrangement which he knows or suspects facilitates the acquisition, use, control or retention of criminal property.

Criminal property is defined widely as property that constitutes or represents a person's benefit from criminal conduct. So it would include benefits obtained as a result of a bribery offence. What this means is that a person who deals with the proceeds of a bribe, knowing or suspecting them to be such, may be committing a money laundering offence (in addition to any offence under the Bribery Act).

These offences are subject to a maximum penalty of 14 years in prison or an unlimited fine, or both. In other words, the penalties are harsher than under the Bribery Act: a salutary thought for the director of a company who has either participated in or uncovered evidence of bribery involving his company and is deciding on his and the company's best course of action.

The main defence to a charge of money laundering is disclosure to the relevant authorities. If a person knows or suspects (or, in some cases, simply has reasonable grounds for knowing or suspecting) that another person is engaged in money laundering, he must file a report with the Serious Organised Crime Agency. A failure to report is an offence in itself with the maximum penalty being five years in prison or an unlimited fine or both.

What is more, reports made to the Agency are typically shared with other law enforcement agencies including the SFO so, while there is no positive reporting obligation under the Bribery Act, the POCA requirements will inevitably bring the issue of self-reporting to the top of the agenda given the risk of committing a money laundering offence. And if a report is made to the Agency, is that sufficient to constitute self-reporting for Bribery Act purposes?

These are just some of the questions that companies will need to consider in the months and years ahead. The bottom line is that, if a corporate uncovers evidence of bribery or corruption, even if it may have a defence under the Bribery Act, it (and its officers) ignore their obligations under POCA at their peril.

By Jeremy Cole, head the Global Bribery and Corruption Task Force at Hogan Lovells and Louise Lamb, a partner in the firm's Financial Services Litigation team

Does money mind if we say it's evil?

The UN Human Rights Council has declared that business must respect human rights. Banks need to take a good hard look at themselves, before somebody else does

"Money doesn't mind if we say it's evil, it goes from strength to strength."
Martin Amis, Money, 1984

Last month, the Special Representative of the UN Secretary General on business and human rights, Professor John Ruggie, delivered his final report to the Human Rights Council. In an unprecedented step and after years of divisive debate, the Council has unanimously endorsed his Guiding Principles on Business and Human Rights.

Although labelled "a common global platform for action" the Guiding Principles offer only high-level guidance and the precise steps that financial institutions will need to take to adapt their policies, procedures and other governance arrangements remain unclear. While institutions will have to develop models that best suit their individual needs, implementation of the Guiding Principles cries out for a coordinated and proactive response from the sector.

The end of the beginning

Professor Ruggie was appointed Special Representative in 2005, shortly after the UN voted down a controversial proposal to impose legally binding human rights obligations on transnational corporations. During the first three years of his mandate, Professor Ruggie crafted a new policy framework comprised of three pillars. First, under international law, States have a duty to protect human rights against abuses committed by third parties, including corporations. Second, although corporations do not (generally speaking) have obligations under international law, society expects that they will "respect" human rights. Third, there is a need to improve access to remedies for victims of business-related human rights abuse.

In 2008, the so-called Protect, Respect and Remedy framework was unanimously welcomed by the Human Rights Council and Professor Ruggie's mandate was renewed for three years so that he could develop detailed recommendations regarding implementation. Even though they are the product of extensive consultation with States, businesses and other stakeholders, the Guiding Principles are not intended to be a comprehensive code. Professor Ruggie himself has said that they "will not bring business and human rights challenges to an end [but they establish] a common global platform for action." The Guiding Principles create no new obligations, but as an authoritative expression of the existing legal framework, they have received widespread endorsement from the business community.

Human rights due diligence

The Guiding Principles explain that the corporate responsibility to respect human rights means that corporations must "avoid infringing on the human rights of others and should address adverse human rights impacts with which they are involved." This responsibility exists independently of States' ability or willingness to discharge their legal duties to promote and protect human rights and "over and above" compliance with national law. In essence, this means that when operating in countries where protection for human rights is inadequate, businesses may need to take additional precautions to ensure that they are not causing or contributing to human rights abuses.

Businesses are advised to discharge their responsibility by undertaking "human rights due diligence" and by taking steps to help remedy any negative human rights impact that their activities may cause. The commentary to the new human rights chapter in the OECD Guidelines for Multinational Enterprises, which is largely based on the Guiding Principles, suggests that human rights due diligence can be incorporated in "broader enterprise risk management systems provided that it goes beyond simply identifying and managing material risks to the enterprise itself to include the risks to rights-holders."

The concept of human rights due diligence is elaborated in some detail in the commentary to the Guiding Principles, but the core elements are:

Impact assessment: the business should conduct risk or impact assessments to identify the actual and potential human rights impact of its activities.

Integration: the findings of impact assessments should be integrated into internal decision making processes so that the business can respond to and avoid negative impacts.

Monitoring and reporting: the business should monitor how actual and potential impacts are addressed, and incorporate the results of this monitoring into its other internal reporting processes.

The Guiding Principles encourage businesses to publicly report on their human rights performance and the steps they have taken to avoid or address negative impacts. Revised guidance on enterprise disclosure policies included in the OECD Guidelines also recommends public reporting of material information regarding human rights performance.

CSR is not enough

The Guiding Principles recommend that a business should express its commitment to respect human rights by adopting a policy, approved at the most senior level and setting out its expectations of staff and business partners. This commitment should be reflected in operational policies and processes so that it is embedded throughout the business. The commitment should be made public and "communicated actively" to business partners and persons whose rights are potentially affected by the business' activities.

It would be wrong to assume that the responsibility to respect human rights (as elaborated in the Guiding Principles) will be discharged through adhering to commitments encapsulated only within the framework of an existing corporate social responsibility (CSR) policy. To the extent that CSR is understood by many businesses as an exercise in maximising and promoting the socially positive impacts of their activities, a CSR policy is unlikely to be good enough. As the commentary to the Guiding Principles explains, no credit can be given for philanthropic deeds if other activities of a business have a negative impact on human rights:

Business enterprises may undertake other commitments or activities to support and promote human rights, which may contribute to the enjoyment of rights. But this does not offset a failure to respect human rights throughout their operations.

Asset or liability?

While CSR initiatives and adherence to voluntary codes of conduct undoubtedly enhance a business' reputation, advertising a

commitment to good corporate citizenship can become a liability if the principles espoused on paper are not upheld in practice. Commitments are scrutinised by NGOs, journalists and other civil society actors and will be labelled hypocritical if transactions which violate the business' own policies or standards are identified.

In the wake of the recent popular uprisings across the Middle East, many banks have been criticised for doing business with the region's despots or have found themselves in the uncomfortable position of having to explain to regulators the extent and nature of their dealings with regimes accused of gross human rights abuses. Elsewhere, a coalition of civil society actors called BankTrack has created an online database of what it labels "dodgy deals", and the banks behind them. The harm that this sort of publicity causes to an institution's reputation is difficult to quantify, but significant enough that most will wish to avoid it.

Some civil society actors had been hoping that Professor Ruggie would recommend the creation of an international system to deal with complaints against business. Although there will not be any UN sponsored mechanism in the near future, avenues for third parties to bring complaints exist at various domestic and intra-State levels. In this respect, the revision of the OECD Guidelines to include specific recommendations relating to human rights is of particular relevance for the financial sector due to the potential for NGOs and other third parties to submit complaints to a National Contact Point in an OECD member State.

The specific instance procedure enables the National Contact Point to investigate allegations against a business, make findings on whether conduct has fallen short of the Guidelines and issue recommendations on how grievances might be resolved. It may also make recommendations on steps the business should take to bring itself into compliance with the Guidelines and require the it to demonstrate progress by submitting follow-up reports. The outcomes of this procedure are public. Following the inclusion of specific recommendations regarding human rights, it is a mechanism which NGOs and others concerned by corporate accountability are likely to use with renewed vigour.

In search of the gold standard

The financial sector has been a leader in developing policies and processes to manage the social impacts of business. Institutions which are familiar with the IFC's environmental and social Performance Standards and the Equator Principles have a head start on many other businesses, particularly in terms of understanding what a human rights impact assessment might involve. However, neither the Performance Standards or the Equator Principles are specifically directed at human rights impacts and, in any event, only apply to certain transactions. The universality of application of the Guiding Principles means that financial institutions will need to consider how they are discharging the responsibility to respect human rights across all areas of their business.

Some efforts to develop sector-specific guidance building on the Guiding Principles are underway. For example, it is expected that the forthcoming revisions to the Performance Standards will include additional requirements in relation to human rights impact assessment drawing upon the Guiding Principles. Additionally, the Equator banks are considering whether it is feasible to extend the application of the Equator Principles beyond project finance so that they will also apply to corporate loans where the majority of funds are used to finance a single asset. Outside the context of assessing the human rights risks and impacts associated with project financing, however, some very difficult issues remain to be addressed.

It is unrealistic to expect that guidance designed generically for the financial sector will suffice. Efforts to develop practical policies and tools need to take account of the types of firms and businesses covered – ranging from investment banks to private equity firms, insurance companies and ratings agencies – and the ever broadening array of services and products offered by the sector.

The commentary to the Guiding Principles (and the OECD Guidelines) says that the responsibility to respect human rights exists even when a business has no direct involvement in activities that impact upon human rights. Identifying the point at which a business clearly has a responsibility to take steps to avoid or prevent an impact is not easy, and determining what steps should be taken is even harder.

The commentary to the new human rights chapter in the OECD Guidelines notes that a business may be able to use its influence with third parties (including States) to prevent human rights abuses – by terminating business relationships, for example. In this context, businesses must also assess whether any attempt to influence a third party might aggravate the situation. This is an area fraught with difficulty and this brief commentary on the topic belies the complexity and sensitive nature of the issues involved. The private sector might be tempted to respond with the increasingly frequent lament that it is being expected to act as a quasi-regulator in situations where governments have repudiated their own regulatory responsibilities.

Whither the State?

The Guiding Principles do not create new legal obligations for States. However, governments are warned that that they may breach their international human rights law obligations if they fail to take appropriate steps to prevent and redress the abuse of human rights by businesses or other private actors. Some States have denied that international law obliges them to take specific steps to regulate human rights impacts of business. On the other hand, a number of States (including the UK and US) recognise that government action may be required.

Other areas in which governments may act to attempt to bring about behavioural change through indirect measures include conditions attached to export credit guarantees, public procurement criteria and reporting requirements, such as Sections 1502 and 1504 of the US Dodd-Frank Act which require disclosure in relation to trade in minerals from conflict affected areas and payments made to governments by extractive sector companies.

The EU has indicated that the Guiding Principles are influencing the design of a new CSR policy, which is expected to include reporting requirements relating to human rights performance.

Although the Guiding Principles are intended to assist businesses to discharge their responsibility to respect human rights even in the absence of State action, Professor Ruggie has hinted that the private sector might welcome well-designed national laws. On the other hand, given that the financial crisis has resulted in an unprecedented volume of new legislation impacting upon banks, it would not be unreasonable for the sector to feel overwhelmed by the prospect of further regulation in an area as complex as this.

While governments are getting a grip on their own priorities, there is a window of opportunity for the financial sector to have a significant influence on the form and content of any future legislation.

In particular, should banks and other financial institutions take coordinated and proactive steps to embrace and give effect to the Guiding Principles, the need for additional State regulation will be greatly diminished.

By Rae Lindsay and Antony Crockett of Clifford Chance

THE REVIEW OF
SECURITIES & COMMODITIES REGULATION
AN ANALYSIS OF CURRENT LAWS AND REGULATIONS AFFECTING THE SECURITIES AND FUTURES INDUSTRIES

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THE UK BRIBERY ACT 2010

The new Bribery Act, which came into force on July 1 of this year, is broadly drafted and is likely to result in increased anti-corruption enforcement in the U.K. against both domestic companies and foreign companies that carry on a business or part of a business in the U.K. In this article, the authors describe the Act, discuss some of the guidance documents issued to date, and identify potential areas of focus for enforcement authorities.

By Stephen Fishbein, Philip Urofsky, and Richard Kelly *

An increasing number of large-scale prosecutions of companies have been brought over the past several years for the payment of bribes to obtain or retain business, with correspondingly large penalties. Most of these prosecutions have been brought in the United States, but such prosecutions have been increasingly brought in other jurisdictions as well. The UK, a signatory to a number of agreements requiring countries to adopt effective anti-corruption legislation and actively enforce such laws, has come under sustained criticism in the past for its apparent leniency towards corruption, and its Serious Fraud Office ("SFO") has been seen as lackluster in its approach to dealing with serious cases of bribery and corruption.[1]

The UK Bribery Act 2010 (the "Bribery Act" or the "Act"), enacted last year and which came into force on July 1, 2011, may well be the impetus for a change in the level of enforcement activity by the UK authorities.[2] The extent of the change in the UK's approach to anti-corruption, however, will only be seen once prosecutions are brought under the Act. Although a flood of

[1] Many companies have settled prosecutions in both the UK and the US. However, the settlements in the UK have consistently

footnote continued from previous column...

been considerably lower than the corresponding fine in the US. For example, Johnson & Johnson paid a fine of $70 million in the US, but its UK-based subsidiary paid a sum of only £5 million in the UK. Likewise, BAE Systems PLC paid a $400 million fine in the US, but settled a claim in the UK by paying a total of only £30 million.

[2] The Act, as enacted, can be found at the following link: http://www.legislation.gov.uk/ukpga/2010/23/contents/enacted.

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prosecutions is unlikely, a single successful prosecution can act as a deterrent to other potential offenders. We can therefore expect that, despite the SFO's limited budget and staffing, the SFO will seek an opportunity to bring a prosecution as soon as possible, both to provide an example of the scope and breadth of the new law, and to demonstrate its commitment and ability to enforce it.

In this article, we provide some context for the Bribery Act and a description of the various offenses it creates. We then address some of the issues raised by the Act and the guidance issued by the UK government. Finally, we offer some views on potential areas of focus for enforcement authorities.

HISTORICAL BACKGROUND

Bribery has long been a criminal offense under English law. Specific statutory offenses were created under the Prevention of Corruption Acts 1889-1916, but the offense of bribing has been prosecuted under the common law for centuries. These laws, however, had become antiquated and were ambiguous in a number of respects, including in their application to transnational bribery. The Bribery Act repealed the outdated existing law and created a number of new offenses.

The UK signed the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (the "OECD Convention") in December 1997.[3] The OECD Convention criminalizes the bribery of foreign public officials in international business transactions. However, for years following its accession to the Convention, the UK failed to bring any prosecutions against any company for bribery. In contrast, the US has taken a strong line to corporate bribery and corruption ever since the introduction of the Foreign Corrupt Practices Act ("FCPA") in 1977. The number of prosecutions under the FCPA is increasing, and several US and foreign companies have been convicted in, or otherwise resolved, criminal proceedings with substantial fines and continuing oversight by the US authorities. In addition, in a number of cases, the US authorities have charged employees, officers, and agents of such companies, exposing them to the risk of substantial fines and incarceration. In the light of this, it is perhaps understandable that the UK has been described as 'soft' on bribery and corruption in comparison, particularly in relation to the SFO's investigation into corrupt conduct by BAE.[4]

There have long been calls for reform of the UK's anti-bribery laws. In 2008, the OECD completed a special review of the UK's record in fighting foreign bribery, concluding that it was "disappointed and seriously concerned with the unsatisfactory implementation of the [OECD] Convention by the UK."[5] In the decade following the OECD Convention, a number of reports recommended a revision of the existing laws. A Law Commission final report entitled "Reforming Bribery" was published in November 2008,[6] and this led to a draft Bribery Bill and ultimately Royal Assent for the Bribery Act in April 2010.[7]

THE BRIBERY ACT

The Bribery Act is drafted broadly, and deliberately so. The government intended the scope of the Act to be delineated through the use of published guidance, prosecutorial discretion, and the judiciary. However, this approach has created uncertainty in the law, and companies should therefore take note of the potentially broad scope of many of the provisions in the Act.

The Bribery Act contains a number of bribery offenses. There are two general offenses in sections 1

[3] http://www.oecd.org/dataoecd/4/18/38028044.pdf.

[4] The SFO controversially terminated its investigation into BAE in 2006 on the grounds of national security following intervention by the then Prime Minister, Tony Blair. However, following subsequent investigations by the SFO, in 2010 BAE agreed a final settlement of all charges with the SFO, by agreeing to pay a total of £30 million, comprising both a fine and an ex gratia payment for the benefit of Tanzania. *R v BAE Systems PLC* [2010] EW Misc 16 (CC).

[5] http://www.oecd.org/dataoecd/23/20/41515077.pdf.

[6] http://www.justice.gov.uk/lawcommission/docs/cp185_Reforming_Bribery_report.pdf.

[7] http://www.justice.gov.uk/news/press-release-300311a.htm.

and 2, under which, essentially, it is an offense to pay a bribe and it is an offense to receive a bribe, including in a purely commercial, private-to-private context.[8] This is known as the supply (or active) and demand (or passive) side of bribery respectively. More specific offenses are found in sections 6 and 7. Section 6 creates an offense of bribery of foreign public officials with the intention of obtaining or retaining business or a business advantage. Section 7 creates a corporate offense of failing to prevent bribery, pursuant to which a commercial organization is guilty of an offense if a person associated with it pays a bribe with the intention of obtaining or retaining business or a business advantage for that organization. This is a strict liability offense, but a commercial organization has a defense if it has in place "adequate procedures" to prevent persons associated with it from committing bribery.

As a general rule, in the UK corporate liability depends on the "identification principle," that is, whether a particular unlawful act was authorized by a "directing mind" of the corporation.[9] The section 7 corporate offense extends corporate liability to acts committed by "associated persons" who do not meet the traditional identification test. However, due to the perception that corporations have less control over the acts of such "associated persons," who may be lower-level employees or agents, the Bribery Act provides corporations with an affirmative defense if they can demonstrate that they had in place "adequate procedures" to prevent bribery by such associated persons. Significantly, however, there is no such defense provided for liability under the other sections of the Act, especially section 1 (active bribery) and section 6 (bribery of a foreign public official). Therefore, a corporation will not be able to avail itself of the "adequate procedures" defense where a bribery offense under those sections was authorized or controlled by its management.

The adequate procedures defense is therefore crucial in allowing commercial organizations to avoid extensive liability for acts over which they have limited control. As noted by the Ministry of Justice, "The objective of the Act is not to bring the full force of the criminal law to bear upon well-run commercial organizations that experience an isolated incident of bribery on their behalf." Thus, it is not clear how often the SFO will seek to bring cases under section 7, where it would have to contend with the adequate procedures defense, as opposed to prosecutions under sections 1, 2, and 6 of the Bribery Act if it has sufficient evidence that the offense was committed by a natural person who was the directing mind of the organization.

Furthermore, under section 14 of the Bribery Act, a senior officer of a company may also be held liable if an offense under section 1, 2, or 6 is committed by a body corporate with the consent or connivance of that senior officer. This is similar to "control person" liability under section 10(a) of the U.S. Securities Exchange Act of 1934, with the significant distinction that it imposes criminal rather than civil liability on the senior officer. It is noteworthy that the Director of the SFO has said that senior officers who commit an offense under this provision will be an important target for the SFO.[10] Despite this, section 14 has received markedly less comment than other sections of the Act. It will give senior officers of large companies cause for concern, and give them particular cause to take an active interest in bribery prevention, since it exposes such officers to the risk of an unlimited fine or imprisonment for up to 10 years, or both. Transparency International has gone so far as to say that section 14 could be engaged by passive acquiescence of that officer if that amounted in practice to consent to the bribery.[11] However, the Director of the SFO has indicated that if a senior officer is "completely ignorant, [he or she] would not have the requisite mental intent," but where that senior officer "turn[s] a blind eye, that is connivance."[12]

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[8] In summary, section 1 provides that a person is guilty of an offense where that person offers, promises, or gives a financial or other advantage to another person, with the required knowledge or intent. Section 2 broadly provides that in certain circumstances a person is guilty of an offense where that person requests, agrees to receive, or accepts a financial or other advantage.

[9] The identification principle acts to limit corporate liability, since a company will only be criminally liable for acts committed on its behalf by sufficiently senior officers within the corporation where that officer is acting as the company in performing the act in question. If the employee responsible for the criminal act is not operating as the directing mind of the corporation, for example because he or she is a lower-level employee, then the corporation itself may be able to avoid criminal liability.

[10] http://www.gibsondunn.com/publications/pages/SFODirectorAldermanVisitsAgainWithGibsonDunn-DiscussesBriberyActEnforcement.aspx.

[11] Transparency International: Briefing note, December 2010.

[12] http://www.gibsondunn.com/publications/pages/SFODirectorAldermanVisitsAgainWithGibsonDunn-DiscussesBriberyActEnforcement.aspx.

GUIDANCE

Under section 9 of the Bribery Act, the Secretary of State is required to "publish guidance about procedures that relevant commercial organizations can put in place to prevent persons associated with them from bribing." After an extended period of comment and debate, the Ministry of Justice published final guidance to this effect in March 2011.[13] At the same time, the Director of the SFO and the Director of Public Prosecutions ("DPP") published joint guidance on prosecutions under the Bribery Act, which is intended to set out the approach to prosecutorial decision making with respect to the Act.[14] Both guidance documents are likely to prove important to any forthcoming prosecutions. However, neither of these guidance documents actually amends the Act itself, and it is not clear to what extent the courts will adopt the same interpretation of the Act as is set out in the published guidance.

The Ministry of Justice guidance provides six principles of bribery prevention: proportionate procedures, top-level commitment, risk assessment, due diligence, communication (including training), and monitoring and review. The government intends these principles to be "flexible" in application and "not prescriptive." While compliance with the guidance will not necessarily prove that an organization has in place adequate procedures to prevent bribery, an organization that does not follow the guidance will not automatically be considered to have inadequate procedures.

The joint prosecution guidance confirms that before bringing a case the prosecution needs to be satisfied (as with other criminal offenses): (a) that there is enough evidence to prosecute; and (b) that it is in the public interest to prosecute. At its highest, the public interest test could prevent prosecutions such as the initial SFO investigation into BAE which, as noted above, was terminated in 2006 on the grounds of national security. While other prosecutions may turn on less critical public interest considerations, the joint prosecution guidance emphasizes that there will generally be a prosecution unless the public interest factors against a prosecution outweigh those factors in its favor. In addition, offenses cannot be prosecuted under the Bribery Act without the consent of the DPP, the Director of the SFO, or certain other officials, as set out in section 10 of the Act.

The UK government also expects business groups to publish sector specific guidance for companies. The British Bankers' Association ("BBA") has already announced its intention to issue such guidance, and this is likely to be forthcoming in the near future. While the BBA guidance will not trump the guidance published by the government, financial institutions should read both in conjunction with each other, as compliance with both will provide evidence that a firm has in place adequate procedures to prevent bribery.

The greatest impact of the Bribery Act may be felt by small- and medium-sized enterprises that have not, to date, adopted anti-corruption compliance programs.[15] Many larger companies, especially those that operate internationally, have already adopted and implemented programs designed to ensure compliance with the FCPA and should therefore require little by way of amendment to their existing policies and procedures to meet the standard for "adequate procedures." Further, in response to the risk of liability resulting from the acts of "associated persons," which may include suppliers, contractors, and joint venture partners, it is likely that larger companies will impose compliance requirements on smaller companies as a condition of doing business.

PLEA BARGAINING

The US authorities' success in enforcing the FCPA against corporations is due, in part, to the practice of plea bargaining, in which the government and the putative defendant reach an agreement in advance on the charges to be filed and the penalties to be imposed. This system has led to a range of potential outcomes in corporate prosecutions, from plea agreements that merely recommend a sentence to the court to ones that require the court to state its acceptance of the recommendation before accepting the plea, and even to various forms of deferred prosecutions in which the defendant corporation admits the critical facts and agrees to pay a penalty but is not required to enter an actual guilty plea. These agreements enable both parties to avoid the risks and burdens of trial while affording them the certainty of a definite outcome.

One difficulty in improving the UK's record in bringing prosecutions for bribery may be the relative lack of acceptance of plea bargaining by the English courts. The Serious Organised Crime and Police Act

[13] http://www.justice.gov.uk/guidance/docs/bribery-act-2010-guidance.pdf.

[14] http://www.sfo.gov.uk/media/167348/bribery%20act%20joint%20prosecution%20guidance.pdf.

[15] In this respect, the UK government published a "Quick start guide" aimed at smaller companies: http://www.justice.gov.uk/guidance/docs/bribery-act-2010-quick-start-guide.pdf.

2005 provides that a prosecutor (such as the SFO) can enter into a written agreement with a defendant who pleads guilty for that defendant to assist with the investigation. Such an agreement may result in a reduction in the sentence which would otherwise be imposed. However, in a number of recent cases the courts have insisted that such written agreements between the parties cannot dictate the sentence that will be imposed, as judicial discretion in sentencing must be upheld.[16] The courts have therefore questioned the ability of the SFO to enter into settlement agreements with a defendant where that agreement specifies the sentence that the court should impose.[17]

As a result of this judicial reluctance to accept plea bargains, the SFO may be hesitant in including recommendations or stipulations concerning the penalty in any future plea agreements. However, the Director of the SFO gave a speech in June 2010 in which he stated that the SFO is still committed to using plea negotiations in an appropriate way in the right cases,[18] and the Attorney General's guidelines on plea discussions in cases of serious or complex fraud explicitly anticipate plea negotiations taking place between the SFO and defendants.[19] However, there are certain criteria which must be followed in such discussions. For example, the parties must not suggest what sentence the judge should impose, as this would be perceived as improperly attempting to limit judicial discretion. While this does not prevent the parties from relying on plea bargains, they should not seek to limit the powers of the judiciary, as "the court retains an absolute discretion as to whether or not it sentences in accordance with the joint submission from the parties."[20] In this context, the Director of the SFO has said that he wants to "ensure that future sentencing submissions are drafted in a way that takes account of the guidance we have received. This is, as I see it, a question of how we draft the documents; it does not, as some seem to have suggested, affect our commitment to using plea negotiations in an appropriate way in the right cases."[21]

Under the Bribery Act, plea negotiations are likely to be increasingly sought by companies that want to avoid a criminal investigation and a potentially unlimited fine. However, it remains to be seen what the general approach of the English courts will be to such negotiations. It is possible that in response to the courts' hostility to negotiated penalties, the SFO may explore alternative resolutions. In this context, the SFO's guide on self-reporting indicates that it is keen to settle certain self-referral cases civilly wherever possible, for example where the company works with the SFO and is committed to resolving the issue.[22] In addition, it has been reported that the SFO is seeking new powers such as the ability to use deferred prosecution agreements.[23]

POTENTIAL AREAS OF FOCUS FOR ENFORCEMENT AUTHORITIES

The Bribery Act is likely to lead to an increasing focus on enforcement. Although these are difficult cases to investigate and, in the absence of effective plea bargaining, to prove at trial, we may see a number of prosecutions in the near future. There are certain specific areas on which the SFO is likely to focus in determining what prosecutions to bring. However, in this context and despite the guidance that has been published to date, there are a number of points of uncertainty concerning how the Act will be interpreted. Although companies understandably want clear statements of principle as to what they can and cannot do, the prosecuting authorities do not want to limit their prosecution options in particular cases. While it is

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[16] For example, *R v Dougall* [2010] EWCA Crim 1048 (*per* Lord Judge CJ: "In this jurisdiction a plea agreement or bargain between the prosecution and the defence in which they agree what the sentence should be, or present what is in effect an agreed package for the court's acquiescence is contrary to principle") and *R v Innospec Limited* [2010] EW Misc 7 (EWCC) (*per* Thomas LJ: "It is clear, therefore, that the SFO cannot enter into an agreement under the laws of England and Wales with an offender as to the penalty in respect of the offence charged").

[17] It should be noted, however, that the suggested sentence agreed between the parties has nonetheless been applied by the courts in a number of cases.

[18] http://www.sfo.gov.uk/about-us/our-views/director's-speeches/speeches-2010/the-whitehall-and-industry-group.aspx.

[19] http://www.attorneygeneral.gov.uk/Publications/Documents/AG's%20Guidelines%20on%20Plea%20Discussions%20in%20Cases%20of%20Serious%20or%20Complex%20Fraud.pdf.

[20] *Id.*

[21] http://www.sfo.gov.uk/about-us/our-views/director's-speeches/speeches-2010/the-whitehall-and-industry-group.aspx.

[22] http://www.sfo.gov.uk/media/28313/approach%20of%20the%20sfo%20to%20dealing%20with%20overseas%20corruption.pdf.

[23] In the US, non- and deferred prosecution agreements, which are essentially non-judicial resolutions of criminal charges, are commonly used in FCPA cases by the Department of Justice.

difficult to predict on what areas the SFO will focus in prosecutions, companies would be well-advised to focus on the following areas of ambiguity when drafting or amending their compliance procedures.

Foreign Companies

One of the criticisms surrounding the Bribery Act is that offenses could potentially be committed through conduct with no specific connection with the UK, particularly under section 7 which applies to any company that "carries on" a business or a part of a business in the UK. As the Head of Policy at the SFO has indicated, the broad jurisdictional reach of the Act will be a key tool in its enforcement by the SFO.[24] In fact, we expect the SFO to seek opportunities to apply the Act to non-British companies so as to demonstrate that British companies are not put at an unfair competitive disadvantage through compliance with the Act's stringent new requirements. As a result, the SFO is particularly likely to prosecute foreign companies for violations of the Act that work to the detriment of British companies. Indeed, the SFO has indicated that it "intend[s] to adopt an aggressive interpretation of the Act's jurisdictional reach."[25]

In contrast to the somewhat bellicose tone of the SFO, the Ministry of Justice indicated in its guidance that a "common sense approach" will be taken to the jurisdictional reach of the Bribery Act. Notably, and despite fears to the contrary, it stated that the mere fact that a company's securities are admitted to trade on the London Stock Exchange would not of itself mean that that company was carrying on a business or part of a business in the UK, and a parent company will not carry on a business in the UK merely because it has a UK subsidiary. Instead, to fall within the scope of the Act, commercial organizations need to have a "demonstrable business presence" in the UK.

If the US experience is any guide, then jurisdictional issues may not be addressed until the end of an investigation. Therefore any company even potentially subject to the provisions of the Act – for example because it "carries on" part of a business in the UK – is subject at least to the risk of investigation, with all its concomitant expense and reputational harm, even if, at the end of the day, the SFO concludes that there is insufficient evidence of UK jurisdiction. Indeed, although the UK's former Attorney General, Lord Goldsmith, has expressed a concern that the Ministry of Justice guidance has made it too easy for foreign companies to avoid liability and thus created an uneven playing field between foreign and UK-based companies, the Director of the SFO has warned that the SFO may investigate the activities of a London-listed company even where the listing is the only UK connection and that companies generally should not rely on technical arguments that they are outside the scope of the Bribery Act. Thus, the exact contours of the "carries on a business" element of the section 7 offense are unlikely to be fully defined until we have case law on the Act, which may take many years, and guidance is not likely to be available at the inception of any investigation.

Associated Persons

The section 7 offense introduces the concept of corporate liability based upon the acts of "associated persons." Therefore, a company can potentially be prosecuted if (for example) its subsidiaries, agents, contractors, joint venture partners, or even its suppliers pay a bribe. In this context it is notable that in a number of recent FCPA enforcement actions the bribes in question were paid through suppliers and contractors.[26] Businesses would therefore be wise to undertake more extensive due diligence of suppliers and other "associated persons." For example, under the Bribery Act, it is very likely that a supplier who either pays a bribe or assists in generating off-the-books slush funds will be viewed as "performing services" rather than simply supplying goods and therefore be held to be an "associated person."

Businesses have expressed a concern that too broad a definition of associated persons would require commercial organizations to undertake an inordinate amount of checks and due diligence on business partners and subsidiaries. The Ministry of Justice guidance sought to assuage such concerns by stating that liability will not accrue merely because of corporate ownership or investment, or solely by virtue of the existence of a joint venture. Instead, the person paying the bribe must intend to benefit the particular commercial organization. For example, if an employee of a subsidiary pays a bribe

[24] http://www.sfo.gov.uk/about-us/our-views/other-speeches/speeches-2011/icc-conference-hosted-by-herbert-smith.aspx.

[25] *Id.*

[26] *See, e.g.*, *SEC v. York Int'l*, Dkt. No. 07-cv-1750 (D.D.C. 2007) (suppliers); *SEC v. GE InVision, Inc.*, Dkt. No. 05-cv-0660 (N.D. Cal. 2005) (distributors); *SEC v. International Business Machines Corp.*, Dkt. No. 00-cv-3040 (D.D.C. 2000) (subcontractor) (pleadings for the three above named actions can be found at the Shearman & Sterling FCPA Digest website *at* http://fcpa.shearman.com).

which only indirectly benefits the parent company because of increased dividends, the guidance indicates that this will not automatically mean that the required intention to benefit the parent company is present. It would be different where the employee of the subsidiary pays a bribe with the intention of obtaining or retaining business for the parent company.

However, while parent companies, subsidiaries, and joint ventures are separate legal persons, we doubt that in practice the SFO will require evidence that a particular bribe was intended to put money directly into the parent company's coffers. For example, parent companies and joint venture partners may profit indirectly from the acts of their subsidiaries and joint venturers. In this context, it is worth noting that the joint prosecution guidance states that it "is necessary to take into account all the relevant circumstances" in establishing whether a person is an associated person for the purposes of the corporate offense.[27] Therefore the prosecuting authorities are likely to bring an action where a parent company or joint venture partner directed, authorized, or controlled the subsidiary's or joint venturer's corrupt conduct with the expectation that a financial benefit would accrue to the parent company in some way.

Corporate Hospitality

Although many companies already have policies in place in relation to corporate hospitality, the absence of an explicit exception in the Bribery Act for legitimate marketing efforts has brought this issue to the forefront of many companies' concerns.

Under the Bribery Act, excessive corporate hospitality may be an offense when dealing with a foreign public official or even in a purely commercial context. However, the Act does not state what level of corporate hospitality will be considered reasonable and what will be viewed as excessive and result in a prosecution. The Ministry of Justice guidance states that "reasonable and proportionate hospitality and promotional or other similar business expenditure" is not prohibited. However, it also recognizes that such expenditure can be employed as bribes where there is an intention to secure business or a business advantage.

The Ministry of Justice guidance sets out a number of factors that may bear on whether the government (and ultimately the prosecuting authorities) will infer that a promotional expense has been given with a corrupt intent, including the type and level of advantage offered, the manner and form in which the advantage is provided, and the level of influence the particular individual has over awarding the business. By way of example, the Ministry of Justice guidance provides that reasonable hospitality, such as fine dining and attendance at a sports match, are of themselves unlikely to raise the necessary inferences. On the other hand, a five-star holiday that is unrelated to a demonstration of the relevant commercial organization's services is far more likely to raise the necessary inference. However, all of the circumstances of each case will need to be considered in determining whether the expenditure was made with the required intention.

In the absence of clear evidence that bribery took the form of corporate hospitality, it is unlikely that it will be in the public interest to bring a prosecution for such hospitality. Corporate hospitality is a well-established business practice, and the aim of the Bribery Act is not to stifle legitimate business activity. Without a specific incident of corporate hospitality clearly amounting to bribery, any prosecutions in this area would be likely to do more harm than good to UK companies going forward. Nevertheless, companies should be wary of providing corporate hospitality under circumstances that raise questions as to the business purpose of the expense. For example, in a number of recent prosecutions under the FCPA, the U.S. government has charged bribery or books-and-records violations based on expensive gifts and travel being provided to officials.[28]

Facilitation Payments

Under the Bribery Act, as under the old common law, facilitation payments are illegal. This may be contrasted with the FCPA under which such payments, although not encouraged, are excluded from coverage. The joint prosecution guidance indicates that not all instances in which facilitation payments are paid will be prosecuted and suggests the factors that will be used to determine whether to prosecute such payments as violations of the Act. For example, large or repeated payments tend to support prosecution, while a single, small payment would not. These are, however, only guidelines, and the joint prosecution guidance says that a prosecution will usually take place unless the public interest factors tending against prosecution outweigh those tending in favor. This makes it clear that the authorities consider facilitation payments to be clear breaches of the Act and

[27] http://www.sfo.gov.uk/media/167348/bribery%20act%20joint%20prosecution%20guidance.pdf.

[28] *E.g.*, *SEC v. Lucent Techs. Inc.*, No. 07-cv-02301 (D.D.C. 2007).

should be eliminated on both a national and international stage.

It is, therefore, likely that in time prosecutors in the UK will bring a case charging facilitation payments. However, as with all criminal prosecutions, this will only be the case where there is a public interest to prosecute. If the payments are small, or one-off, it is unlikely that the required public interest would be present. On the other hand, we would not be surprised if the SFO took the opportunity of emphasizing the Act's prohibition on facilitation payments by including the prosecution of facilitation payments in cases in which the company is also charged with paying bribes to officials to obtain or retain business.

Books and Records Requirements

The FCPA requires companies whose securities are listed in the US to maintain accurate books and records and to implement internal financial controls. It is a rare case in which a bribe is accurately described in a company's books and records, and thus these offenses are often tacked on to bribery offenses. Moreover, in cases in which the government faces jurisdictional difficulties in charging an FCPA bribery offense, it may charge books-and-records violations in lieu of the bribery offense, with much the same penalties. While the Bribery Act does not contain equivalent provisions, the UK's Financial Services Authority ("FSA") does impose organizational requirements on authorized firms that can also apply to the activities of such firms carried on outside the UK. It is likely that the Act will serve as a further spur for companies to adopt procedures to ensure that they do not breach the Act in the first place and to provide a basis for an adequate procedures defense if they do.

Even in the absence of the Bribery Act, the FSA has begun to take a more active role in policing this area. Beginning in late 2008, it began to examine whether UK financial institutions, particularly insurance brokerages, had sufficient anti-bribery controls. Since then, in January 2009, the FSA fined Aon Ltd £5.25 million and, most recently, in July 2011, it fined Willis Group Holdings Ltd. £11 million, in each case finding that the companies had failed to take reasonable care to establish and maintain effective systems and controls to counter the risks of bribery and corruption associated with making payments to overseas third parties. In its Final Notice to Aon, the FSA found that between January 14, 2005 and September 30, 2007, as a result of Aon Ltd's weak control environment, Aon had made various suspicious payments amounting to approximately $7 million to a number of overseas firms and individuals. Aon Ltd's failures were found to have resulted in an unacceptable risk that it could become involved in potentially corrupt payments to win or retain business. Similarly, in its Final Note to Willis, the FSA found that between 2005 and 2009 the company had failed to prevent approximately £160,000 in "possible bribes" as part of the £27 million it had paid to "overseas third parties who assisted it in winning and retaining business from overseas clients."

While the FSA's powers undoubtedly stretch to enforcement action for failure to have in place effective systems and controls to prevent bribery and corruption, where *criminal* activity is evidenced the FSA will refer the case to the SFO. However, the FSA has indicated that it may carry out further investigations in this area, and especially into the anti-bribery and corruption systems and controls of investment banks.[29] Therefore FSA-regulated firms that do not have in place adequate anti-bribery systems and controls are at risk of both FSA enforcement action and a prosecution under the Bribery Act.

CONCLUSIONS

If aggressively enforced, the Bribery Act will present a significant risk of liability to corporations doing business internationally. In most cases, such risk may well overlap with that already presented by the FCPA, while in others it may provide additional risk for companies operating outside the broad jurisdictional reach of the FCPA.

Nevertheless, it is important not to overreact to this risk. Although it is not clear at this early stage how the "adequate procedures" defense to the corporate offense will work in practice, the UK government's recognition that companies cannot always control the conduct of every person or entity associated with them is significant. Moreover, having adequate procedures in place may well mitigate the risk of liability even for the other offenses under the Bribery Act which are subject to the identification principle, by reducing the risk that senior officers will engage in unlawful conduct on behalf of the corporation. Thus, as is always the case, the best defense is a strong offense; in this case, the offense should be a rigorous compliance program designed to detect and deter unlawful conduct by any person acting on behalf of the corporation.

[29] FSA's 2010/11 Business Plan. http://www.fsa.gov.uk/pubs/plan/pb2010_11.pdf.

Many companies, including small- or medium-sized enterprises that do business with larger global companies, are likely to already have adequate compliance structures in place. Those that do not are well-advised to conduct a review of their business operations and the corruption risks they face, and to implement procedures designed to detect and deter improper conduct on their behalf. Given the scope of the Bribery Act (and the FCPA), these procedures must necessarily address not only internal risk related to the conduct of officers and employees but also external risk presented by "associated persons" such as agents, suppliers, contractors, and partners. ■

Simon Jerrum, an associate based in London, provided invaluable assistance in the preparation of this article. *This article is intended only as a general discussion of these issues and should not be regarded as legal advice under the laws of the United Kingdom or otherwise.*

THE GLOBE AND MAIL

Opinion

Joining the global dialogue on corporate social responsibility

ED WAITZER

From Friday's Globe and Mail
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In our hyper-integrated global economy, corporate performance and resilience is increasingly vulnerable. When things go wrong, reputational risk moves quickly through, and up, supply chains. Activists have learned to leverage this to effect social change – and corporate leaders are becoming equally adept at managing, rather than being managed by, public expectations.

It's not surprising that decision-makers – from courts to legislators, business leaders to institutional investors – are re-thinking market norms and corporate cultures. Debate is heated about what the values in business should be, and how they can be used to legitimize business activities.

Canada, with its relatively concentrated, resource-based economy and progressive social policies, has focused on sustainability issues, including the corporate responsibility to respect human rights. In March, 2009, a new corporate social responsibility (CSR) strategy was laid out for the Canadian extractive sector (mining, oil and gas). It spelled out concrete measures, including establishment of a CSR counsellor to assist in the resolution of issues arising from activities of Canadian companies abroad.

Development of legal instruments that reflect this reassessment of corporate "citizenship" and consequential accountability mechanisms is still at a relatively early stage. It is complicated by globalization, which blurs the lines of responsibility and authority, as well as the fact that the foundations of corporate law (such as separate legal personality and limited liability) have historically hindered accountability for corporate actions.

This was part of the challenge facing John Ruggie, a professor at Harvard's Kennedy School of Government, when, in 2005, he was appointed by the United Nations to identify and clarify standards of corporate responsibility and accountability on human rights, including the role of states. In 2008, after extensive consultations, Mr. Ruggie proposed a policy framework to manage business and human-rights challenges.

The framework, unanimously embraced by the UN Human Rights Council, outlined three distinct responsibilities: the state's duty to protect against human rights abuses; the corporate responsibility to respect human rights (by acting with due diligence to avoid infringing the rights of others); and greater access to remedies for victims.

The rights council then asked Mr. Ruggie to go a step further and provide guidance on how countries and businesses could implement this "protect, respect and remedy" framework. After more rounds of consultations (including one convened in Toronto by Osgoode Hall Law School) and the input of law

firms around the world (including Stikeman Elliott LLP in Canada), on whether and how corporate and securities laws foster corporate cultures respectful of human rights, Mr. Ruggie recently released a significant blueprint for public comment

His "Guiding Principles" framework brings together social ideals and operational practicalities. It helps to frame, and make operational, an emerging international consensus, starting with the need for states to adopt a more comprehensive approach to address business-related human rights impacts, and to encourage business enterprises to respect human rights.

The blueprint explains how respecting human rights means putting in place policies and processes, appropriate to a business's size and circumstances, to identify, prevent and mitigate any adverse impacts on human rights which the business might cause or contribute to. It also spells out why it is important that a business articulate its commitment to human rights to all employees, business partners and relevant stakeholders.

The Supreme Court of Canada recently noted that responsible corporate conduct should involve consideration of the broader consequences of business – though it gave little practical guidance for corporate boards on how to act on such ideals. That's why Mr. Ruggie's Guiding Principles are a breakthrough in the CSR dialogue: They identify – in tangible ways that can be endorsed and implemented practically – how business enterprises, as well as governments, can help prevent human rights abuses.

The Guiding Principles deserve the support and practical commitment of the business community. Mr. Ruggie is welcoming public feedback on his blueprint, through a dedicated online forum, until Jan. 31, 2011.

Anyone involved or interested in the challenges of corporate social responsibility, including governance and accountability, should take part in this crucial global discussion.

Ed Waitzer holds the Jarislowsky Dimma Mooney Chair in Corporate Governance at York University, is a partner of Stikeman Elliott LLP and a former chair of the Ontario Securities Commission.

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Financial Post

News

Should we pay for whistle-blowing?

Edward Waitzer, Financial Post · Mar. 22, 2011 | Last Updated: Mar. 22, 2011 4:04 AM ET

The new chairman of the Ontario Securities Commission recently announced that it may implement a whistle-blower program as part of a concerted effort to enhance its enforcement regime.

He specifically referred to the program introduced under the Dodd-Frank Act in the U.S. Unlike traditional whistle-blower procedures (such as that established two years ago by the Investment Industry Regulatory Organization of Canada), the Dodd-Frank Act authorizes the Securities and Exchange Commission, the Commodity Futures Trading Commission, the Department of Justice and self-regulatory organizations to pay whistle-blowers a 10% to 30% bounty from monetary sanctions of over US$1-million recovered as a result of original information about securities and commodities law violations.

The provisions were a reaction to criticism of the SEC's existing whistle-blower program, which only authorized rewards for information leading to successful insider trading prosecutions. They are modelled on financial incentives in the U.S. False Claims Act (a whistle-blowing statute targeting fraud by federal government contractors), which led to the recovery of US$2.4-billion in 2009.

The Dodd-Frank legislation excludes certain categories of individuals (e.g., those who obtain information during a required audit or through communications that are subject to the attorney-client privilege) and information (e.g., information obtained from a company's internal compliance functions, if that information is disclosed by the company to the regulatory authority within a reasonable time). However, the class of potential whistle-blowers extends beyond current and former employees to third parties (such as consultants and contractors) whose dealings with a company may allow them to gather and provide "original information" with a view to collecting a bounty.

In the U.S., the Sarbanes-Oxley Act of 2002 required companies to establish procedures for the receipt of complaints on an anonymous and confidential basis. This has proven a powerful tool for uncovering and addressing corporate wrongdoing. The Canadian Securities Administrators followed suit in their Corporate Governance Guidelines, requiring codes of business conduct and ethics that address the reporting of illegal or unethical behaviour.

While a wide range of other Canadian regulatory statutes (particularly in areas such as health and safety or environmental law) contain extensive anti-retaliation protections for whistle-blowers, the use of financial rewards as an incentive for whistle-blowing has yet to find favour. Before implementing such provisions, we should pause to reflect on several fundamental issues.

For one, how might a bounty program interact with existing procedures? To what extent will the prospect of substantial financial rewards give employees (and others) a powerful incentive to bypass existing compliance programs? Will the Dodd-Frank whistle-blower provisions put corporate agents in a conflict of interest, with potential personal gain trumping their duties to act in the company's interest? Will this, in turn, detract from other regulatory efforts to encourage companies to adopt effective internal compliance and disclosure programs? Should whistle-blowers be required to report internally and wait a reasonable time for the company to do the right thing before being able to seek a bounty?

Consideration might also be given to the attractiveness of whistle-blower bounty provisions when compared with relatively nascent private securities class action litigation under Canadian securities laws. Do we risk cutting off the development of this mode of private enforcement and shifting costs back to public agencies? How do we strike the right balance between internal compliance programs and various forms of public and private enforcement? To what extent are the choices further complicated by new "enforcement" mechanisms, such as WikiLeaks?

Should we be considering other approaches to encouraging whistleblowing? For example, a U.K. charitable organization, Public Concern At Work, not only lobbies for effective whistle-blower standards and assists corporations in implementing whistle-blower support programs, but also provides advice and assistance to employees who raise "matters of public concern." Other organizations (such as the General Accountability Project in the U.S.) conduct legal clinics and make awards to employees who expose unsafe or illegal activities. Should securities regulators be investing in this sort of infrastructure, as they seem prone to do with financial literacy initiatives?

The time may be ripe to ramp up whistle-blower programs, particularly in the financial services sector. Presumably, employee and public outrage has mounted with the public perception that corporate misconduct fuelled the recession. Hopefully, the OSC will think

through what works best to reinforce and capitalize on this personal sense of caring about and responsibility for institutional wrongdoing without undermining other efforts to promote effective corporate cultures.

? Edward Waitzer is a senior partner of Stikeman Elliot LLP, a professor and director of the Hennick Centre for Business and Law at York University and a former chairman of the Ontario Securities Commission.

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Financial Post

FP Comment

Whistleblower debate: Speak truth to power

Special to the Financial Post Mar 24, 2011 – 11:00 PM ET | Last Updated: Mar 24, 2011 11:07 PM ET

The risks are borne by the whistleblower, while the benefits go to the victims

By Dimitri Lascaris

In a recent article, *Should we pay for whistleblowing?* (March 22), Edward Waitzer questions whether securities regulators should offer financial rewards to whistleblowers. While any such regime should be crafted carefully to ensure the integrity of the information obtained through such rewards, the principle of whistleblower compensation is sound and should be implemented at the earliest opportunity.

Those who act for investors in securities litigation, and who have dealt extensively with whistleblowers, understand the perils to which whistleblowers expose themselves. Public corporations possess vastly greater resources than whistleblowers and often employ those resources to deter disclosure of managerial misconduct.

First, a public company can subject a whistleblower to a groundless legal claim that the whistleblower breached a confidentiality obligation. The cost of prosecuting that claim is likely to be immaterial to the company, but the cost of defending that claim, even successfully, can be devastating to the whistleblower. Second, the company could also seek to discredit the whistleblower in the public domain, and can deploy its considerable public relations resources to do so. Third, by revealing that a previous employer committed fraud, whistleblowers not only ensure that their previous employer will be of no assistance to them as they seek new employment, but they can also cause themselves to be blackballed in the industry in which their employment prospects are greatest.

Speaking truth to power is a risky matter. Moreover, those risks are borne entirely by the whistleblower, while the benefits of the fraud disclosure flow entirely to the victims of the fraud. Compensating whistleblowers alleviates this free-rider problem to a considerable degree. In the absence of compensation, a prospective whistleblower may well ask, and many do, why he or she should place his or her family's livelihood, savings and reputation at considerable risk by exposing the misdeeds of the powerful. From time to time, some brave souls expose misconduct with nothing to gain but the satisfaction of having done the right thing. But our society should not demand heroism from those with knowledge of misconduct, not if we are serious about ensuring respect for the law.

Mr. Waitzer asks whether compensating whistleblowers will shift costs from private enforcement to public agencies. The answer is that it would lower the costs for both private and public enforcement. Finding evidence of fraud is often like searching for needles in a haystack, but the whistleblower knows where the needles lie, and relieves both private litigants and regulators of the burden of pouring through all the hay.

The U.S. experience with compensating whistleblowers is instructive. Under the U.S. False Claims Act, those who knowingly submit false claims for payment of government funds are liable for three times the government's damages plus civil penalties. Moreover, the False Claims Act contains "qui tam" or whistleblower provisions, allowing those with evidence of fraud against government contracts and programs to sue on the government's behalf to recover the stolen funds. As compensation for the risk and effort of prosecuting a qui tam case, the whistleblower may be awarded a portion of the funds recovered, typically between 15% and 25%.

The results to date have been impressive. Since the False Claims Act was amended in 1986, total recoveries under the act by federal and state governments exceed US$28-billion.

It's time for Canada to recognize the realities of fraudulent activity and to treat those who expose fraud, at great risk to themselves, in an equitable manner. By doing so, we will all be better off. Except for the fraudsters.

Financial Post
Dimitri Lascaris, a partner in the law firm of Siskinds LLP, devotes his practice to the prosecution of securities class actions and derivative actions on behalf of aggrieved investors.

Edward Waitzer responds:

While Dimitri Lascaris and I often find ourselves on opposite sides of litigation, we agree that any bounty program for whistleblowers should be carefully crafted. As I tried to suggest, the issues extend beyond ensuring the integrity of the information obtained through

such rewards. My key concern relates to the impact on efforts by companies to implement effective internal compliance and disclosure programs. Acting too quickly, in adopting new regulation as in handling allegations of wrongdoing, often creates bigger problems than those targeted.

The recent Renault SA whistleblower saga demonstrated the risks to rushing through an internal investigation (as might be encouraged under the Securities and Exchange Commission's proposed rules, which would put tremendous pressure on companies to deal with whistleblower complaints within 90 days). An anonymous tip accusing a senior executive of negotiating a bribe led to his dismissal (along with two other managers) after a four-month investigation. While the employees professed innocence, Renault's CEO said the company had evidence against them. Earlier this month, Renault exonerated the three for lack of evidence. In the meanwhile, the French police have arrested two employees who were involved in the internal probe.

Consider, as well, the capacity of the Ontario Securities Commission to administer a bounty program. In the post-Madoff era, it will be difficult for the regulator to dismiss any possible claim without conducting an investigation of its own and being prepared to account for its decision. Can the OSC cope with this responsibility? What incremental resources will be required?

My comment wasn't intended to discourage financial rewards for whistleblowers. The key is to anticipate, rather than react, both in the design of regulatory instruments and, more importantly, in ensuring that companies have in place and publicize to employees the existence of strong and objective procedures and a "speak-up" culture that encourages internal reporting when concerns arise.

Edward Waitzer is a senior partner of Stikeman Elliot LLP, a professor and director of the Hennick Centre for Business and Law at York University and a former chairman of the Ontario Securities Commission.

Posted in: FP Comment Tags: OSC, SEC, Whistleblowers

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CORPORATE GOVERNANCE REPORT
Volume 6, Number 3

CHANGES TO EXECUTIVE COMPENSATION DISCLOSURE ADOPTED

By John Tuzyk

The Canadian Securities Administrators (CSA) have adopted amendments to Form 51-102F6 *Statement of Executive Compensation* under National Instrument 51-102 *Continuous Disclosure Obligations* (the Amendments). The Amendments come into force for proxy circular disclosure for issuers for financial years ending October 30, 2011 or later, so they will be in effect for the upcoming proxy season.

Although the current Form 51-102F6 came into force relatively recently, after an extensive comment process, for the 2009 proxy season, the new Amendments significantly change executive compensation disclosure requirements, including changes to the stated objectives of the required disclosure, with new additional required disclosure relating to risk management, performance goals, fees paid to compensation advisors, bench-marking information, compensation committees, valuation of equity-based amounts, future changes to compensation policies and practices, officer and director hedging, and the value of vested share-based amounts and changes to disclosure relating to pension plan benefits.

Despite extensive comments, the Amendments are substantially unchanged from those published for comment in November 2010 by the CSA (the Proposal), as described in our December 2010.

Summary

The substantive changes are:

- New disclosure is required in the Compensation Discussion & Analysis (CD&A) as to whether the board of directors, or board committee, has considered the implications of the risks associated with the issuer's compensation policies and practices and, if the implications have been considered, disclosure is required as to:

- the extent and nature of the board's or committee's role in the risk oversight of compensation policies and practices;
- any practices the issuer uses to identify and mitigate compensation policies and practices that could encourage a named executive officer (NEO) or individual at a principal business unit or division to take inappropriate or excessive risks; and
- any identified risks arising from the policies and practices that are reasonably likely to have a material adverse effect on the issuer.
- The disclosure of performance goals based on corporate-wide financial performance metrics is deemed not to seriously prejudice issuers for the purposes of the exemption from the disclosure of specific performance goals for NEOs, meaning an exemption from the disclosure of such goals on this basis will not be available.
- An issuer is required to state if it is relying on the "serious prejudice" exemption to exclude disclosure of specific performance goals.
- New CD&A disclosure is required as to future changes in compensation practices and policies.
- The Summary Compensation Table cannot be altered by adding columns.
- Expanded disclosure requirements have been adopted relating to compensation committees.
- Expanded disclosure requirements have been adopted relating to compensation advisors, including all fees paid to compensation advisors for executive compensation and other services.
- The requirement to disclose non-compensatory amounts for defined contribution plans is removed.
- Disclosure is required as to whether any NEO or director is permitted to purchase financial instruments that are designed to hedge a decrease in the market value of equity securities granted as compensation.
- Regardless of whether there are any differences between the valuation of equity-based awards disclosed in the Summary Compensation Table and the accounting fair value of such awards, issuers are required to disclose the methodology used to calculate grant date fair values of such awards.

- The disclosure currently required relating to the process the issuer uses to grant option-based awards is extended to all share-based awards.
- New disclosure of the market value of vested share-based awards in the Outstanding Awards Incentive Plan Awards table is required.

New Risk Management Disclosure

Consistent with new rules adopted by the U.S. Securities and Exchange Commission amending compensation and corporate governance disclosure requirements for U.S. companies for the 2010 proxy season (2010 SEC Amendments), the Amendments expand CD&A requirements to require issuers to disclose whether or not the board of directors, or a board committee, has considered the implications of the risks associated with the issuer's compensation policies and practices. (It will be interesting to see if any issuer discloses it has not considered the risk implications.) If the implications were considered, the issuer is required to disclose:

- the extent and nature of the board's or committee's role in the risk oversight of compensation policies and practices;
- any practices the issuer uses to identify and mitigate compensation policies and practices that could encourage an NEO or individual at a principal business unit or division to take inappropriate or excessive risks; and
- any identified risks arising from the issuer's policies and practices that are reasonably likely to have a material adverse effect on the issuer.

In addition, the Amendments add commentary which provides examples of situations that could potentially encourage an executive officer to expose the issuer to inappropriate or excessive risks, such as compensation policies and practices:

- at a principal business unit of the issuer or a subsidiary that are structured significantly differently than others within the issuer;
- for certain executive officers who are structured significantly differently than other executive officers within the issuer;
- that do not include effective risk management and regulatory compliance as part of the performance metrics used in determining compensation;

- where the compensation expense to executive officers is a significant percentage of the issuer's revenues;
- that vary significantly from the overall compensation structure of the issuer;
- where incentive plan awards are awarded upon accomplishment of a task while the risk to the issuer from that task extends over a significantly longer period of time; and
- that contain performance goals or similar conditions that are heavily weighed to short-term rather than long-term objectives.

The Amendments add a new such example to those set out in the Proposal, being incentive plan awards that do not provide a maximum benefit or payout limit.

Given these new disclosure requirements, issuers would be prudent to consider whether such risks are currently considered as part of their compensation policies and practices, and whether any policies or practices in this regard should be established, formalized, documented, or enhanced, in particular if any of the examples provided apply in their circumstances.

New Limits on Use of Serious Prejudice Exemption for Disclosure of Performance Conditions

Under the current Form 51-102F6, there is an exemption from the CD&A requirement to disclose specific performance goals or similar conditions for NEOs if the disclosure would "seriously prejudice the interests of the company".

The Amendments provide that, for this purpose, an issuer's interests are not considered to be seriously prejudiced solely by disclosing performance goals or similar conditions if those goals or conditions are based on broad corporate-level financial performance metrics such as earnings per share, revenue growth, and earnings before interest, taxes, depreciation and amortization (EBITDA). This is a somewhat unique provision where the CSA have deemed for all issuers that disclosure of NEO performance goals based on corporate-wide financial performance measures will not seriously prejudice issuers, notwithstanding the objections of numerous issuers who commented on this proposal.

The Amendments also require an issuer to explicitly state that it is relying on the serious prejudice exemption if it is doing so and explain why disclosing the relevant performance goals or similar conditions would seriously prejudice the issuer's interests. Again, this is a somewhat unique provision as it is not common under securities laws requirements to require issuers to disclose the fact of non-disclosure and disclose the analysis underlying their conclusions as to the reasons for such non-disclosure.

Summary Compensation Table – No Additional Columns Allowed

Relying on the existing provisions of Form 51-102F6, some issuers have previously included additional columns in the Summary Compensation Table in order to provide additional executive compensation disclosure. The Amendments will end that columnar disclosure, as they provide that the Summary Compensation Table cannot be altered by adding columns. The Amendments provide that issuers may choose to add new tables, columns (but not to the Summary Compensation Table) or other information, if necessary to meet the stated objectives of Form 51-102F6 and if to a reasonable person, the table, column or other information does not detract from the prescribed information in the Summary Compensation Table.

CD&A Significance Determination

Of potential importance to issuers may be the response made by the CSA to a comment that the CD&A disclosure requirements should be qualified by a "materiality" threshold. (Unlike most requirements for disclosure under securities laws, executive compensation disclosure requirements (including the CD&A) are not subject to any standard of materiality.) While rejecting this proposed change, in their response the CSA indicated that companies must determine which practices and policies are "significant", potentially allowing issuers to adopt a "significance" standard as to their CD&A disclosure obligations.

New Compensation Committee Disclosure

The Amendments contain a new section which requires more detailed and additional compensation committee disclosure, which overlaps to a certain extent with the requirements contained in Form 58-101F1 *Corporate Governance Disclosure*. The Amendments require disclosure of any policies and practices adopted by the board to determine compensation for the

issuer's directors and executive officers. If the issuer has established a compensation committee, the Amendments require the issuer to disclose or describe:

- the name of each committee member and whether or not each member is independent;
- whether or not one or more of the committee members has any direct experience that is relevant to his or her responsibilities in executive compensation;
- the skills and experience that enable the committee to make decisions on the suitability of the issuer's compensation policies and practices; and
- the responsibilities, powers and operation of the committee.

Consequential amendments have been made to Form 58-101F1 under National Instrument 58-101 *Disclosure of Corporate Governance Practices* to allow issuers to incorporate by reference for that form the foregoing disclosure under the amended Form 51-102F6. Many issuers have previously provided this disclosure, or substantial portions of it, in part voluntarily and in part to satisfy the existing requirements of Form 58-101F1, so this change will not likely have a significant impact on existing disclosure by such issuers.

Disclosure of Compensation Advisors' Services and Fees

Consistent with the 2010 SEC Amendments, the Amendments expand the required disclosure regarding compensation consultants and advisors retained by the issuer to assist the board or compensation committee in determining compensation for the directors or executive officers, including a description of the advisor's mandate and when the advisor was originally retained. (The Amendments oddly require disclosure if a consultant was retained since the most recent completed financial year, i.e., during the year the proxy circular is prepared but not in relation to the year for which executive compensation disclosure is provided in the circular and to which the CD&A relates. We expect many issuers will apply the requirements more logically with respect to the use of advisors in relation to the year which is subject to the disclosure requirements.) The Amendments, changed somewhat from the Proposal in this regard, also require disclosure of any services provided by the advisor or consultant to the issuer, its subsidiaries and affiliates, or any directors or members of management and whether board or compensation committee pre-approval is required for such additional services provided at the request of management. (The introduction of disclosure relating to "management" is novel and who is included in

"management" for this purpose is unclear. As well, the issuer may have no knowledge, and no entitlement to knowledge, as to the use of the advisor at an affiliate, such as a controlling shareholder.)

The Amendments require disclosure of aggregate fees paid to each such compensation consultant or advisor, categorized as Executive Compensation Related-Fees and All Other Fees for the most recent two financial years, irrespective of amount. These requirements are similar to those in National Instrument 52-110 *Audit Committees* for auditors for audit-related, tax and other fees.

Additional Commentary ON CD&A Disclosure

The Amendments require additional disclosure in the CD&A by specifying in the CD&A commentary that the following are additional examples of items that will usually be significant elements of required disclosure concerning compensation:

- whether the board of directors can exercise discretion, either to award compensation absent attainment of the relevant performance goal or similar condition or to reduce or increase the size of any award or payout, including if they exercised discretion and whether it applied to one or more NEOs; and
- whether the issuer will be making any significant changes to its compensation policies and practices in the next financial year.

In an additional change from the Proposal, the Amendments provide in the commentary to the CD&A that, if the issuer used bench-marking in determining compensation or any element of compensation, the benchmark group is to be included in the CD&A as well as an explanation of why the benchmark group and selection criteria are considered by the issuer to be relevant.

Executive Officer and Director Hedging

The Amendments broaden the CD&A requirements to require disclosure of whether any NEO or director is permitted to purchase financial instruments including prepaid variable forward contracts, equity swaps, collars, or units of exchange funds that are designed to hedge or offset a decrease in the market value of equity securities granted as compensation or held, directly or indirectly, by the NEO or director.

Named Executive Officers – Clarification for Subsidiary Employees

The Amendments attempt to clarify that employees of subsidiaries of an issuer may be executive officers, and hence may be NEOs, of the issuer. However, the manner of clarification may create more ambiguity, as the Amendments refer to executive officers of the issuer including its subsidiaries being included in the definition of NEOs of the issuer, which may create confusion that individuals who are executive officers of subsidiaries (such as the CEO of the subsidiary) are executive officers of the issuer, which may not necessarily be the case. The CSA's response to comments on this change indicates that an employee of a subsidiary will be an executive officer of the issuer only if such employee performs a policy-making role for the issuer, which appears to be the correct interpretation based on the underlying policy but which may not be apparent from the wording of the Amendments.

Currency

The Amendments provide that amounts be reported in either Canadian dollars or the same currency as the issuer uses for its financial statements, and if compensation is provided in a currency other than the currency reported, the issuer is to disclose the currency in which the compensation was provided, the currency exchange rate and the methodology used to translate the compensation into the disclosed Canadian or other currency amounts. Accordingly, pursuant to the Amendments, issuers who use a currency other than Canadian for their financial statements may, nonetheless, use Canadian currency for executive compensation disclosure.

In a change from the Proposal, the Amendments provide that currencies other than those used in the Summary Compensation Table may be used in the CD&A, if, for example, performance conditions are specified in a different currency.

Disclosure of Valuation of Equity-Based Awards

Currently issuers are only required to disclose the methodology used to calculate grant date fair values of equity-based awards, including key assumptions and estimates used for each calculation, if the methodology used in the Summary Compensation Table is different from that used for financial reporting purposes. The Amendments require all issuers, regardless of whether there are any differences between the method used for purposes of the Summary Compensation Table and for financial reporting, to disclose the methodology used to calculate grant date fair

values of equity-based awards, including key assumptions and estimates used for each calculation, and why the issuer chose that methodology.

Pension Plan Benefits Disclosure

Under the current Form 51-102F6, issuers are required to disclose in the Defined Contribution Plans (DC Plans) table non-compensatory amounts, including employee contributions and regular investment earnings on employer and employee contributions, for DC Plans. Under the Amendments, the requirement to disclose non-compensatory amounts for DC Plans has been removed.

The Amendments clarify that issuer contributions to a personal savings plan like an RRSP are to be disclosed in the Other Compensation column of the Summary Compensation Table.

As an addition to the changes in the Proposal, the Amendments also provide that for defined benefit plan disclosure, disclosure of the annual lifetime benefit payable must assume that the NEO is eligible to receive payments, i.e., that all vesting conditions have been met. The Amendments also provide a formula for the purposes of quantifying the annual lifetime benefit payable (based on a fraction of the annual benefits payable at the presumed retirement age used to calculate the closing present value of the defined benefit, the fraction being the current years of credited service divided by the credited years at retirement age), while allowing for the use of other formulas if the issuer believes it provides a more meaningful calculation of the benefit.

Objectives Changed: Intended to Pay versus Paid

Currently Form 51-102F6 provides that the objective of required disclosure is to "communicate the compensation the board of directors intended the company to pay". The reference to "intended" has resulted in ambiguity in applying the requirements of Form 51-102F6 by requiring disclosure of intended amounts as opposed to actual amounts. For instance, a compensation committee may establish a bonus program under which it expects certain amounts may be paid to the executive for an expected performance, but the actual results of the bonus program may result in a lower or higher bonus being paid for the year. The Amendments remove this reference to the board's intention and change the objectives of the required executive compensation disclosure. The Amendments provide that the objective is to communicate

compensation paid or payable and add an additional objective to communicate the decision-making process relating to compensation. Similar changes have been made to the Summary Compensation Table requirements relating to option-value disclosure. Certain issuers had relied on the existing requirements to provide option value disclosure based on an allocation of value for multi-year grants intended to compensate the NEO over a number of years, which now will not be permitted.

Expanded Disclosure of Share-Based Awards

Form 51-102F6 currently requires disclosure of the process the issuer uses to grant option-based awards, including the role of the compensation committee and executive officers in setting or amending any equity incentive plan under which option-based awards are granted and whether previous grants are taken into account when considering new grants. The Amendments extend these disclosure requirements to all share-based awards.

In a change not contained in the Proposal, the Amendments provide that for option awards disclosed in the Outstanding Awards Incentive Plan Awards table, if the option was granted in a different currency than reported in the table, footnote disclosure is required as to that currency and the exercise price.

New Disclosure of Market Value of Vested Share-Based Awards

The Amendments require that a new column be added to the Outstanding Awards Incentive Plan Award table to disclose for each NEO the aggregate market or payout value of vested share-based awards that have not yet been paid-out or distributed. While many share-based award plans provide for payout or distribution of awards upon vesting, some plans, most notably deferred share unit plans for directors, do not. For share-based awards which do not provide for immediate payout upon vesting, this requirement will result in repetitive disclosure, as the same vested, non-paid, awards may appear in multiple years' proxy disclosure until paid out.

No Required Disclosure of Amounts Realized Upon Exercise of Equity Awards

The CSA also commented on an amendment that they are not proposing. For financial years ending prior to December 31, 2008, issuers were required to disclose the aggregate dollar value

realized upon the exercise of options or stock appreciation rights. Upon the adoption of the new Form 51-102F6 for 2009, this requirement was replaced by a requirement to disclose specific information about equity-based and non-equity awards in two Incentive Plan Awards tables. The first such table requires issuers to disclose information about all outstanding share-based and option-based awards, which gives readers information about the position of outstanding equity-based awards (both in and out-of-the-money). The second such table shows any amounts an NEO realized during the most recently completed financial year from the vesting of equity-based awards assuming the equity-based award had been exercised on the vesting date. The CSA determined that they would not reintroduce a requirement to disclose the aggregate dollar value realized upon the exercise of options, stock appreciation rights or other equity-based compensation awards, as this represents an investment decision by the executive, not a compensation decision by the issuer.

No Required Disclosure of Comparisons of CEO Compensation To Median Compensation

The 2010 SEC Amendments included a controversial requirement for public companies to disclose:

- the median annual total compensation for the employees (except the CEO);
- the annual total compensation of the CEO; and
- the ratio of the CEO's compensation to the median.

The requirement to disclose the "median compensation" of all employees attracted criticism on numerous grounds, including: difficulty in determining the annual compensation across large work forces, perverse incentives to reduce lower-paid position headcount (for example by outsourcing), issues relating to treatment of employees of non-wholly owned subsidiaries and foreign subsidiaries, and treatment of part-time employees. Given the numerous issues relating to this requirement, and the consequent administrative burdens, issuers will be relieved that the CSA have not included any equivalent requirements in the Amendments.

Effective Date

The new requirements will apply to the preparation of management proxy circulars for issuers with financial years ending on or after October 31, 2011.

USE OF DERIVATIVES BY SHAREHOLDER ACTIVISTS

By Patricia A. Koval

In recent years, hedge funds and other activist investors have relied on equity derivatives strategies to accumulate economic interests in potential takeover or proxy contest targets. So-called stealth accumulations have seemingly increased in both Europe and North America. In Europe, LMVH amassed more than a 20% holding in Hermes, largely through the use of equity derivatives, and in the United States, hedge funds acquired significant economic positions in this manner in Fortune Brands and J.C. Penney, allegedly with a view to exerting control or influence. Such transactions have brought these strategies to the forefront of attention of both activist investors and securities regulators in 2011. In the United States, the Securities and Exchange Commission is actively studying modernizing its reporting requirements to take into account the use of equity derivatives strategies in connection with takeover bids; we understand that the Canadian securities regulators are also considering this.

Typically, these equity derivatives strategies involve cash-settled total return equity swaps or similar vehicles, including, as they are known in Europe, "contracts for differences" (CFDs). In these contracts, while no actual purchase or sale of underlying securities occurs between the purchaser of the swap (the "long" party) and the counterparty, the counterparty will typically hedge its risk by purchasing the underlying securities. The long party will not receive the power to vote the underlying securities or to compel the counterparty to dispose of them. As a practical matter, however, the swap may be "closed out" and "converted" into a direct holding by the long party by cash-settling the swap and using the proceeds to acquire the securities from the counterparty.

Under Canadian and U.S. securities laws, the prevailing view of cash-settled total return swaps has historically been that, absent specific evidence to the contrary, these swaps do not provide the long party with actual or beneficial ownership of, or control or direction over, the underlying securities. Therefore, a party acquiring an economic interest in an issuer under an equity swap of more than 10% of the outstanding equity or voting securities of a class of a Canadian issuer has not typically filed an early warning report or an insider report relating to that interest (although a

party that is already an insider as a result of beneficial ownership of such securities would be required to disclose its acquisition of an economic interest under an equity swap on an insider report under National Instrument 55-104, *Insider Reporting Requirements and Exemptions*). On its face, a party can, in this manner, accumulate an economic interest of virtually any size (including actual beneficial ownership of up to 9.9% of the issuer's securities) in an issuer without making disclosure. A party that is already an insider can increase its economic interest using an equity swap without filing an early warning report or being subject to the associated purchase moratorium on the underlying securities; rather it can simply disclose the position on an insider report filed five days after the transaction (and that report is not required to contain any statement about the party's intentions). In the United States, similarly, a long party would not typically file a report under Section 13(d) of the *Securities Exchange Act of 1934* (the 1934 Act) after acquiring an economic interest under a total return swap in 5% of the common stock of an issuer.

In 2006, the Ontario Securities Commission considered the use of equity derivatives and reporting requirements in the Sears Canada transaction. Although the OSC was unable to conclude on the evidence that cash-settled equity swaps gave a hedge fund beneficial ownership or control or direction over the subject Sears Canada shares, the OSC indicated that the use of swaps to deliberately "park" securities and avoid reporting obligations in the context of a takeover bid could constitute abusive conduct. Subsequently, in 2008, in the proxy contest for CSX, the United States District Court for the Southern District of New York (affirmed on appeal) found that two hedge funds used cash-settled total return swaps and other arrangements to obtain significant economic power over CSX, without disclosure, before launching a proxy contest for seats on the CSX board of directors. Although the Court declined to go so far as to say that a typical cash-settled total return swap creates beneficial ownership, the Court found that, in the circumstances, the conduct of the hedge funds was sufficient to have deemed them to have acquired beneficial ownership; the hedge funds had, according to the Court, entered into these arrangements for the purpose of avoiding their disclosure obligations.

In an effort to protect themselves from stealth acquisitions, some U.S. issuers have included derivative-based long positions in the definition of "beneficial ownership" in their shareholder

rights ("poison pill") plans. In both the United States and Canada, however, these efforts are largely chilled by the position of influential proxy advisory firms. For example, the 2011 voting guidelines of ISS recommend voting against approval of a plan that refers to derivatives contracts in the definition of "beneficial ownership."

The use of equity swaps to acquire economic toeholds or positions of influence has attracted regulatory scrutiny and recent reform outside North America. In the United Kingdom, the Financial Services Authority implemented new rules in June 2009, which contemplate a general disclosure regime requiring aggregation of physical share and long CFD holdings. In Australia, the Australian Takeovers Panel issued an Equity Derivatives Guidance Note that requires disclosure of positions taken in equity derivatives when there is, or can be expected to be, a "control transaction" by purchasers who have a combined long and actual physical position exceeding 5% of the underlying stock. Hong Kong has enacted similar rules to require disclosure of positions taken by way of cash-settled equity derivatives. Germany is expected to enact similar rules in 2011.

Perhaps not surprisingly, the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act) in the United States did not ignore this issue. It will add Section 13(o) to the 1934 Act to provide that beneficial ownership of a security will be deemed to have been acquired on the basis of the purchase or sale of a security-based swap to the extent that the SEC deems it to do so by rule. **[With the July 2011 enactment of this section looming, the SEC is being encouraged to amend the concept of beneficial ownership for purposes of Section 13(d).] [NTD – To update]** For example, Wachtell, Lipton, Rosen & Katz formally petitioned the SEC on March 7, 2011 to reformulate the definition of "beneficial ownership" for this purpose to encompass ownership of any derivative instrument that includes the "opportunity, directly or indirectly, to profit or share in any profit derived from any increase in the value of a subject security" (a formulation similar to "economic interest in a security" found in Canadian securities legislation). On March 17, 2011, in Release No. 34-64087, the SEC reaffirmed that where a security-based swap is used with the purpose or effect of divesting or preventing the vesting of beneficial ownership as part of a plan to avoid the beneficial ownership requirements, the party

concerned may be deemed to have beneficial ownership of the subject securities; the SEC also announced that its staff is engaged in a project to modernize reporting under Section 13(d).

In Canada, the Canadian Securities Administrators, through a consultation paper published in November 2010, commenced a project intended to create sweeping transformational regulation of the Canadian OTC derivatives market; that consultation paper, however, did not address this issue. In Ontario, the December 2010 amendments to the *Securities Act* did expressly extend the prohibition on insider trading with material undisclosed information to related derivatives (including cash-settled derivatives). No amendments have yet been proposed, however, to the early warning reporting rules, but this issue is understood to be under study.

Taken together, these developments are expected to prompt further regulatory scrutiny of the use of equity swaps in contests for corporate control. Canadian securities regulators might be expected to revisit the early warning rules in this context.

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Introduction

The Canadian Coalition for Good Governance ("CCGG") has, since its inception in 2003, encouraged boards of Canadian public companies to voluntarily adopt a number of corporate governance best practices. CCGG members believe that good governance practices and policies are fundamental to ensuring board independence and accountability to shareholders and to building the long-term sustainable value of a company.

Through its policy documents, CCGG provides guidance to public company boards on the perspectives of leading Canadian institutional investors about a variety of corporate governance matters, all of which are available at www.ccgg.ca.

CCGG Study of Shareholder Democracy in Canada

CCGG has conducted the first study on the adoption rates of a number of important governance best practices related to shareholder democracy by S&P/TSX Composite Index (the "Index") issuers, including:

- The appointment of a chair or lead director who is independent of management
- Holding annual director elections with individual director by director votes
- Implementation by the board of a "majority voting" policy
- Detailed disclosure of voting results for director elections, and
- The holding of an annual 'Say on Pay' shareholder advisory vote.

The study focused on the level of acceptance of these good corporate governance practices by companies in the Index as of September 2010 (with data updated to current when new information became available) based on publicly available data, which was verified by confirming letters sent to each issuer. We also investigated the adoption rates of these practices as at April 30, 2003 - the date of the formation of CCGG – of the then companies in the Index to identify trends in these key measures of shareholder democracy.

CCGG retained Dr. Vishaal Baulkaran, a recent PhD graduate from the School of Business and Economics at Wilfred Laurier University, to provide an independent review of the information we collected and to provide an academic perspective on corporate governance trends and related implications.

The detailed CCGG research findings are attached in Appendix A and company-by-company information is available at www.ccgg.ca. CCGG will keep this data current and available on our website and asks any issuer who changes its policies to advise CCGG by email at info@ccgg.ca.

2010-2011 CCGG BOARD OF DIRECTORS

CHAIR
David F. Denison
CPP Investment Board

VICE CHAIR
Dan Chornous
RBC Global Asset Management

DIRECTORS
Bill Chinery
BlackRock

Emilian Groch
Alberta Teachers' Retirement Fund

Stephen A. Jarislowsky
Jarislowsky Fraser

Wayne Kozun
Ontario Teachers' Pension Plan

Larry Lunn
Connor, Clark and Lunn

Brian Murdock
TD Asset Management

Donald F. Reed
Franklin Templeton Investments Corp.

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Key Findings

Significant progress has been made on the adoption of shareholder democracy governance best practices in Canada since 2003, including:

- While slightly more than one third of Index issuers in 2003 had appointed an independent chair, by 2010 the majority of Index issuers had done so – representing 70% of the Index by market capitalization. By 2010, more than two thirds of the boards that did not have an independent chair had appointed an independent lead director, up from 25% in 2003. As a result, by 2010 approximately 88% of Index company boards (92% by market capitalization) had either an independent chair or a lead director.

- Boards with directors having staggered or multi-year terms are now rare in Canada. Only six Index issuers, representing less than 1% of the market capitalization of the Index, still do not hold annual elections for each director.

- By 2010, over 80% of Index issuers (94% by market capitalization) voluntarily permitted shareholders to vote "for" or to "withhold" their votes for each director individually, a dramatic change from 2003 when no issuer had this practice.

- By 2010, more than half of all Index issuers (81% by market capitalization) had adopted a "majority voting" policy – while in 2003 no issuer had adopted majority voting.

- In the 2010 proxy season, 62% of Index issuers (78% by market capitalization) disclosed detailed voting results for their director elections, up from none in 2003.

- In 2010, 44 issuers (19% of Index issuers and 55% by market capitalization) of various sizes and from various industry sectors voluntarily held 'Say on Pay' advisory votes. The number of 'Say on Pay' adoptees has since grown to 80 (May 2011) and CCGG expects this trend to continue.

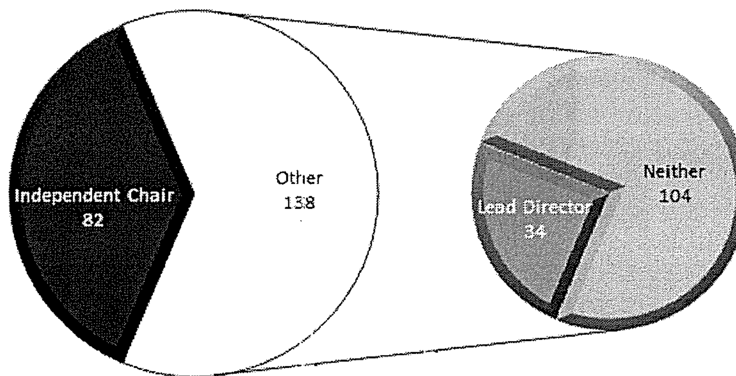
However, even though there has been a significant level of adoption of best practices in shareholder democracy since 2003, many leading Canadian companies have failed to accept the fundamental right of shareholders to be able to effectively vote for or against each individual director nominee, notwithstanding the active encouragement of CCGG since 2006. As at December 31, 2010, a full 43% of the issuers in the Index still had not adopted majority voting – with these companies representing about 20% of the market capitalization of the Index.

Independent Chair/Lead Director

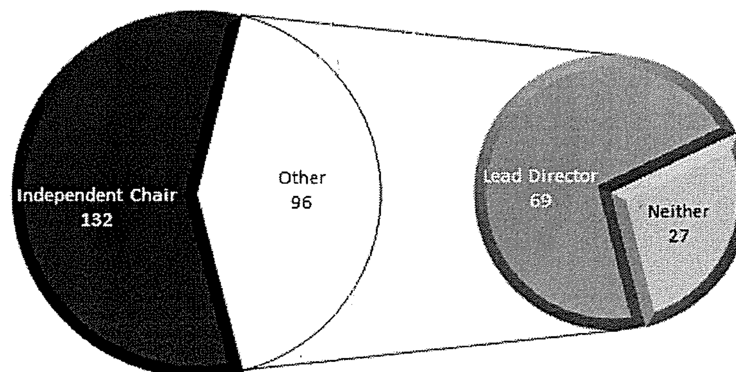
CCGG believes that all public companies should separate the roles of chair of the board and chief executive officer to eliminate potential conflicts of interest and to clarify accountability—the chair to the shareholders and the CEO to the board. If there is an existing chair who is also the CEO, the board should appoint an independent lead director on a transitional basis and confirm to shareholders its plan to appoint an independent chair at the appropriate time.

In 2003, approximately one-third of Index issuer boards had appointed an independent chair. Of the remaining two-thirds who had not appointed an independent chair, approximately one quarter had appointed a lead director. While in 2003 about half of boards had adopted either an independent chair or lead director governance model, by 2010 about 88% of Index company boards (92% by market capitalization) had either an independent chair or a lead director.

Appointment of an Independent Chair, S&P/TSX Composite Index (2003)



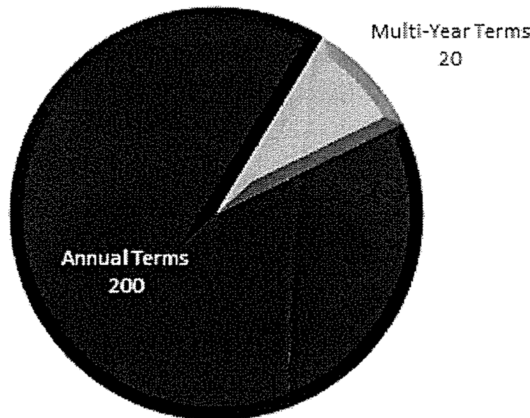
Appointment of an Independent Chair, S&P/TSX Composite Index (2010)



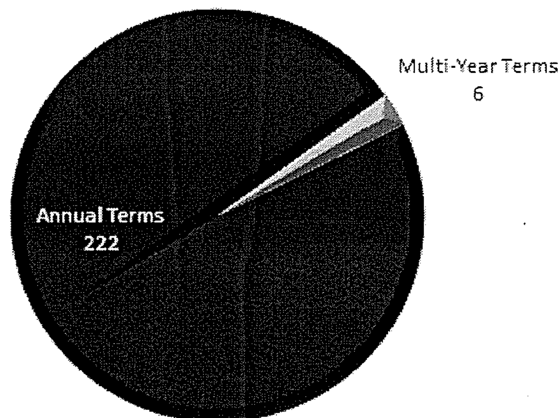
Annual Director Elections

Allowing shareholders to vote for directors on an annual basis - rather than for multi-year or staggered terms - increases the accountability of directors to shareholders and limits the ability of a board to entrench its members. In 2003, 20 issuers still had staggered or multi-year board terms (3% of the Index market capitalization), which had decreased to 6 or 1% of the Index market capitalization in 2010.

Annual Director Elections, S&P/TSX Composite Index (2003)



Annual Director Elections, S&P/TSX Composite Index (2010)

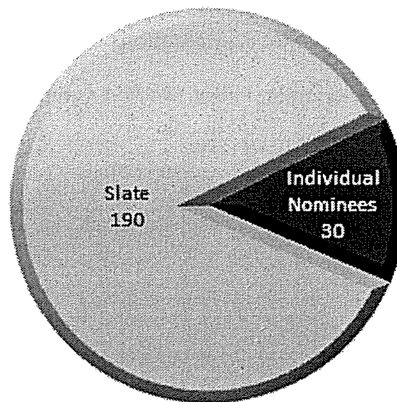


Individual Director Elections

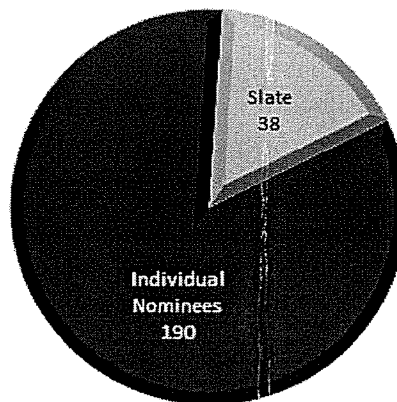
CCGG believes that it is important that shareholders be allowed to vote for each director nominee individually rather than for one slate of all directors. This practice provides valuable information to shareholders, gives feedback to governance and nominating committees of boards on their director recommendations and is an important component of shareholder democracy.

In 2003, most Index issuers used a slate voting system (86%). This practice changed dramatically by 2010. In 2010, only 38 or 17% of Index issuers continued to use a slate voting process, with an overwhelming majority of the Index holding individual director elections – representing 95% of the Index by market capitalization.

Individual Director Elections, S&P/TSX Composite Index (2003)



Individual Director Elections, S&P/TSX Composite Index (2010)



Majority Voting

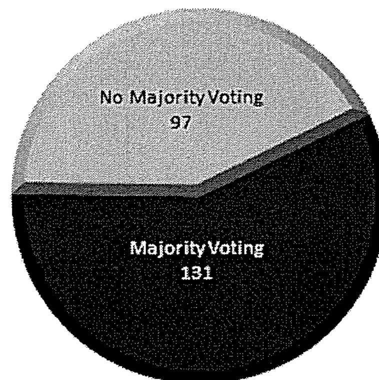
Under Canadian securities laws, the form of proxy requires that director elections be based on a "plurality system" whereby a shareholder can either vote "for" a director nominee or "withhold" its vote. "Withhold" votes are not counted and a director needs only one "for" vote to be elected to the board.

CCGG believes that all directors should have the confidence and support of a majority of their shareholders and should only be elected if a majority of the votes cast are in favour of the election of the individual director. Majority voting policies formalize a process for boards to address situations where a director nominee does not garner the support of a majority of shareholders. See the CCGG's 2011 *Majority Voting Policy* for further details.

In 2003, no Index issuer had adopted a majority voting policy and their shareholders had no effective method of terminating an underperforming director. Following the creation of CCGG's first majority voting policy in August 2006, many leading boards adopted a similar majority voting policy. By 2010, 57% of Index issuers had adopted a majority voting policy, representing 81% of the Index by market capitalization.

Majority Voting Policy, S&P/TSX Composite Index (2003)

Majority Voting Policy, S&P/TSX Composite Index (2010)

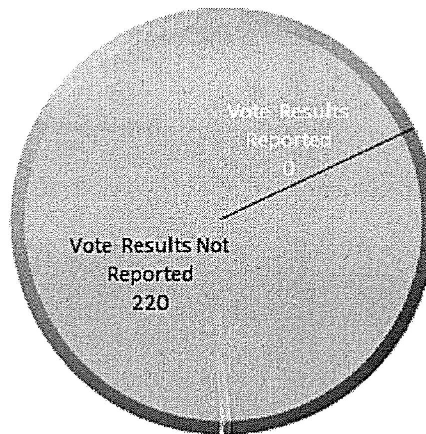


Detailed Disclosure of Voting Results

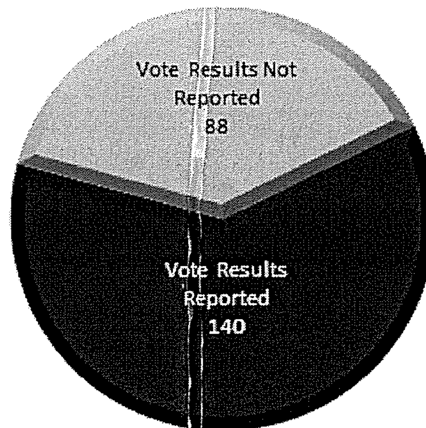
CCGG believes that issuers should promptly disclose detailed voting results after each shareholder meeting to provide shareholders with timely, meaningful information about the outcome of voting at shareholder meetings.

In 2003, no board publicly provided detailed voting results. By the 2010 proxy season, 61% of Index issuers were providing this important information to their shareholders (representing 78% of the Index by market capitalization).

Disclosure of Detailed Voting Results, S&P/TSX Composite Index (2003)

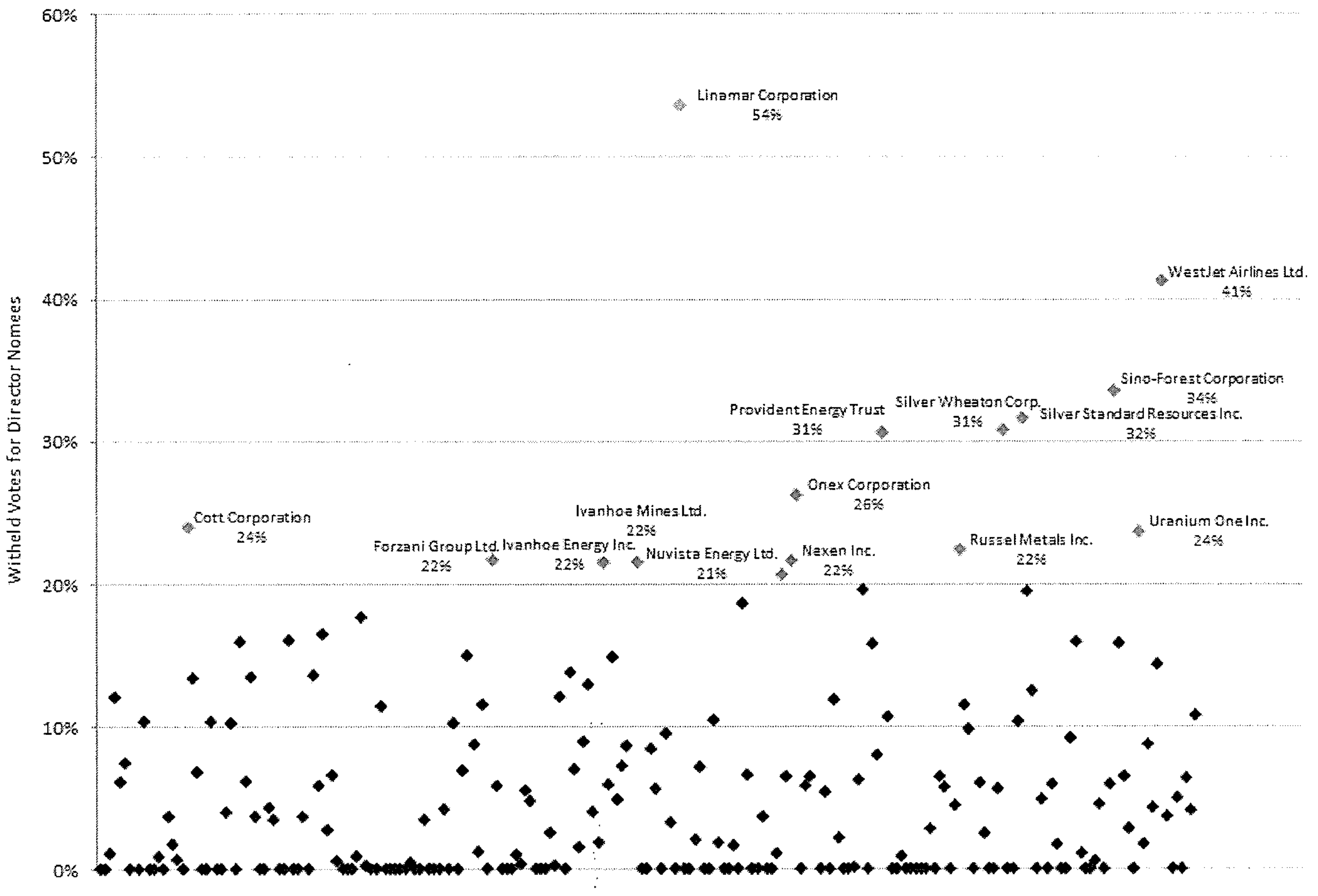


Disclosure of Detailed Voting Results, S&P/TSX Composite Index (2010)



In 2010, a significant number of individual directors or slates received a relatively high number of "withhold" votes, indicating that many shareholders are focusing on the qualifications of proposed directors and value the ability to effectively vote for or against individual directors.

Also in 2010, of the Index issuers reporting detailed voting results, only one issuer had more votes "withheld" than "for" its slate. Fifteen (10.6%) had at least one director receiving less than 80% support "for" their candidacy. On average, the director nominees of issuers that filed detailed voting results in 2010 received the support of at least 91% of votes cast.

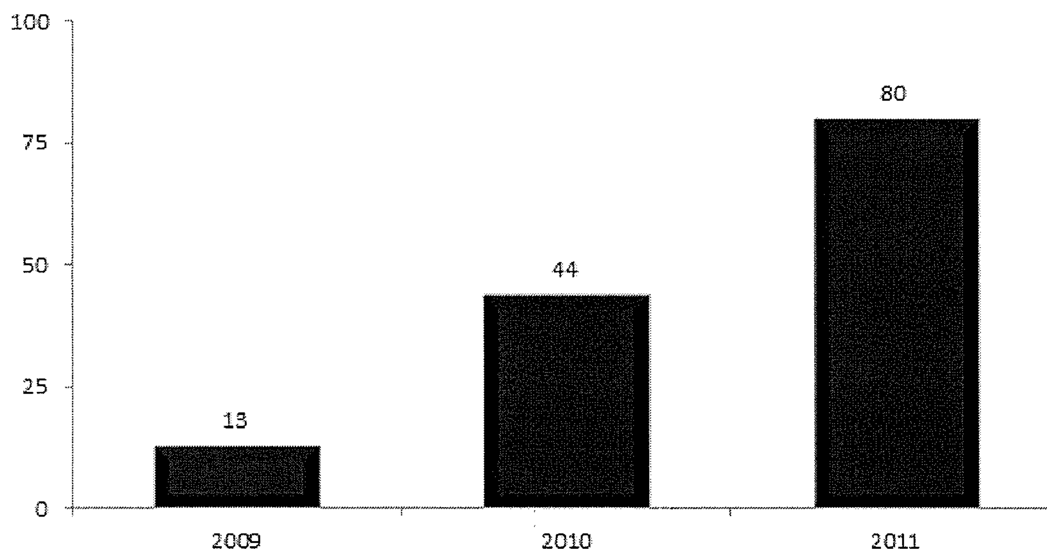


'Say on Pay'

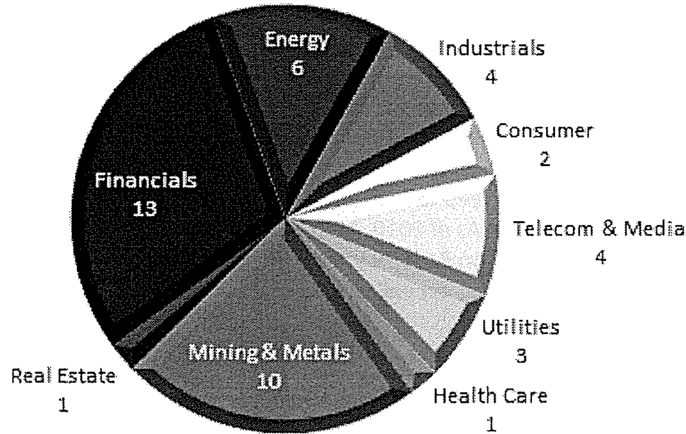
CCGG regards annual 'Say on Pay' shareholder advisory votes as an important part of an ongoing integrated engagement process between shareholders and boards, giving shareholders an opportunity to express their satisfaction with the board's approach to executive compensation in the year as well as over a longer period of time.

'Say on Pay' became a reality in Canada in 2009 and has expanded rapidly. In 2009, CCGG published a model 'Say on Pay' policy to provide guidance to boards on the expected disclosure of their approach to executive compensation, a recommended form of the advisory resolution and what could be done by the board with the results of the vote.

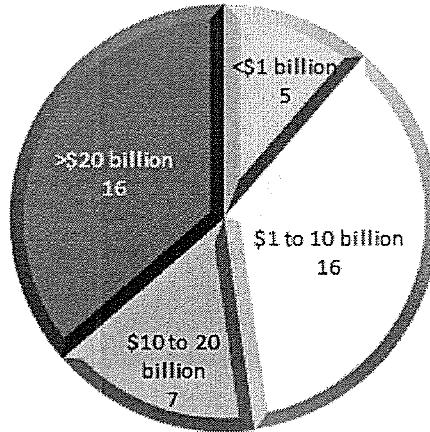
Many leading boards have voluntarily agreed to hold advisory votes on their approach to compensation, with all using the CCGG recommended form of resolution. As of 2010, 44 Canadian issuers had adopted 'Say on Pay' (by May 2011, more than 80 issuers had agreed to adopt 'Say on Pay'). Issuers who have adopted 'Say on Pay' represent most industry sectors, all parts of Canada and have various market capitalizations.



'Say-on-Pay' Adoption by Sector (2010)



'Say-on-Pay' Adoption by Market Capitalization (2010)



Results of the 2010 'Say on Pay' advisory votes indicate a level of support from shareholders ranging between 86.3% and 99.2%. For complete current data on the adoption of 'Say on Pay' by Canadian issuers, see www.ccgg.ca.

Conclusions

Despite a lack of regulatory reform over the last decade in the governance of Canadian public issuers, significant progress has been made in the adoption of governance best practices in Canada since the founding of CCGG in 2003.

Today, most Index issuers:

- Have adopted a governance model of either an independent chair or a lead director
- Hold annual director by director elections
- Disclose the results of director elections.

However, while the boards of most of Canada's largest issuers have agreed that shareholders should be able to elect or reject each director by adopting "Majority Voting", a surprising number of significant Canadian issuers have continued the shareholder unfriendly and archaic practice of plurality voting – over 40% of issuers representing close to 20% of the Index by market capitalization. Not surprisingly, the issuers who have accepted shareholder democracy have also been the leaders in adopting 'Say on Pay', with over 55% of the Index by market capitalization holding or agreeing to hold 'Say on Pay' votes.

Clearly, much more work needs to be done in the Canadian marketplace to ensure that Canadian investors have adequate rights. CCGG intends to continue to work to convince those boards who do not have functioning shareholder democracy to adopt Majority Voting. As well, CCGG is advocating that securities regulators mandate widely accepted shareholder democracy principles in order to require entrenched boards to consider the views of the owners of their company.

APPENDIX A

STUDY RESULTS

Independent Chair / Lead Director

	2003	2010
Independent Chair		
Number	82	132
Percentage of Companies	37%	58%
Percentage of Index (by Market Cap)	52%	70%
Lead Director		
Number	34	69
Percentage of Companies	15%	30%
Percentage of Index (by Market Cap)	17%	22%
Neither		
Number	104	27
Percentage of Companies	47%	12%
Percentage of Index (by Market Cap)	31%	8%

Annual Director Elections

	2003	2010
Annual Elections		
Number	200	222
Percentage of Companies	91%	97%
Percentage of Index (by Market Cap)	99%	99%
Multi-Year Terms		
Number	20	6
Percentage of Companies	9%	3%
Percentage of Index (by Market Cap)	1%	1%

Individual Director Elections

	2003	2010
Individual Elections		
Number	30	190
Percentage of Companies	14%	83%
Percentage of Index (by Market Cap)	30%	95%
Slate		
Number	190	38
Percentage of Companies	86%	17%
Percentage of Index (by Market Cap)	70%	5%

Majority Voting

	2003	2010
Majority Voting		
Number	0	131
Percentage of Companies	0%	57%
Percentage of Index (by Market Cap)	0%	81%
No Majority Voting		
Number	220	97
Percentage of Companies	100%	43%
Percentage of Index (by Market Cap)	100%	19%

Disclosure of Detailed Vote Results

	2003	2010
Vote Results Reported		
Number	0	140
Percentage of Companies	0%	61%
Percentage of Index (by Market Cap)	0%	78%
Not Reported		
Number	220	88
Percentage of Companies	100%	39%
Percentage of Index (by Market Cap)	100%	22%

'Say on Pay'

	2003	2010
'Say on Pay'		
Number	0	44
Percentage of Companies	0%	19%
Percentage of Index (by Market Cap)	0%	55%
No 'Say on Pay'		
Number	220	184
Percentage of Companies	100%	84%
Percentage of Index (by Market Cap)	100%	45%