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Submissions

The Wise Persons' Committee's terms of reference are to review and assess strengths and weaknesses of the current securities regulatory system and to recommend an appropriate regulatory structure, with a governance model and accountability framework. I am a public investor who has recommendations for changes in securities law and enforcement procedures to deter white collar crime at Canadian public companies and to provide a more accessible justice system for public shareowners seeking restitution for their investment losses caused by securities violations. My recommendations focus on changes to enable independent directors of public corporations to become effective gatekeepers on behalf of public investors for the prevention of securities law violations. My recent experience with the Canadian courts and provincial securities commissions also compels me to recommend that there be fundamental changes in how these institutions deal with shareholders seeking restitution for investment losses caused by securities violations. My recent experience as an independent director and public investor was the subject of a Globe and Mail article on April 19, 2003, written by Karen Howlett. This media article is an attachment to this submission.

I have twenty-two years of experience in the Canadian securities industry, including being the head of equities research and a senior Partner and Director at two major investment banks. I have also been an independent director of a British Columbia public company, called Technovision Systems Inc., whose C.E.O reached an October 22, 2002 Settlement Agreement with the British Columbia Securities Commission ("BCSC") on continuous disclosure misrepresentation and stock trading manipulation. I am presently a co-applicant in a shareowners' application before the Ontario Securities Commission ("OSC") that seeks an OSC order for Technovision to bring selective issuer bids and prohibited collateral agreements into compliance with the Ontario Securities Act. The application also seeks an OSC order to implement sanctions on the company, some of its directors and a group of selling shareholders who acted jointly or in concert with the issuer in the unlawful issuer bids.

Small and Large Public Companies Should have a Majority of Independent Directors

I recommend that small and large public companies be treated the same in terms of corporate governance by a majority of independent directors on the Board of Directors and a majority of independent directors on compulsory audit, compensation and nominating committees. If small companies cannot afford these independent directors and committee processes, then they are probably too small to be a public company with access to the funding of public investors.

The independent director's job is to supervise the management of public corporations. One important obligation of independent directors is to ensure that companies operate lawfully and investors are not harmed by issuers and insiders committing securities violations. Independent directors are performing a public gatekeeping function on behalf of existing shareowners and public investors, generally. When independent directors are the majority of directors on a Board of Directors, they have the voting power to stop securities violations at a public company. The TSX Exchange and TSX Venture Exchange have so far resisted

imposing a requirement that all public companies have a majority of independent directors, as is now required of public companies in the U.S. Presently, the Canadian exchanges only requires two independent directors on the Board of Directors, on the reasoning that Canadian public companies are smaller than in the U.S. And they cannot afford to attract a majority of competent independent directors. The OSC recently adopted a new rule for the audit committee of public companies to comprise a majority of independent directors. The OSC has exempted small companies from this new requirement, and requires that small companies simply disclose whether they have an audit committee and who sits on this committee. The public companies that are majority owned by families believe it is inappropriate to have majority independent directors representation on the Board of Directors.

While the majority of small and large public companies operate lawfully, whether independent directors are diligently involved or not, the securities regulatory system needs to be structured to find and prosecute the dishonest people, without crippling everyone else with excessive rules and paper-work. Public investors need to be convinced that they can rely upon the directors and the provincial securities commissions for the enforcement of securities laws.

Support and Protection of Whistleblowing Directors

If Canadian public companies are not required to have a majority of independent directors, then it becomes necessary for the federal and provincial governments to have special legislation and enforcement procedures to protect and support the two independent directors on the Board of Directors who suspect securities violations.

Independent directors must first inform the full Board of Directors when they have concerns about securities violations. The Board of Directors is expected to establish a committee of independent directors to investigate the suspected securities violation. When there is reasonable evidence of the securities misconduct and there is no remedial action taken by the Board of Directors, directors have the obligation to inform the exchanges and provincial securities commissions about the evidence they have on securities violations, otherwise they will be authorizing, permitting and acquiescing to these securities crimes under provincial securities laws.

The independent directors must have the full support and co-operation of the provincial securities commission enforcement division in the investigation of securities violations. The provincial securities commission should be able to make rapid case assessments on complaints received from independent directors. Where there is preliminary evidence of securities misconduct and where the independent director has a record of honesty and responsible conduct, the provincial securities commissions should start an official investigation promptly. The provincial securities commission should be obliged, except in extreme circumstances, to inform the Board of Directors about its investigation and the basis of its concerns. The provincial securities commissions should be required to take enforcement action in all cases where independent directors have brought securities violations to their attention, and where there is sufficient evidence to take enforcement actions. If the provincial securities commission selects only a small minority of complaints from independent directors for investigation and enforcement, then independent directors will be reluctant to whistleblow due to the high personal liabilities of this action. Unless the provincial securities commissions have a policy to enforce where directors find securities misconduct, the best course of action for independent directors who find it is to "head for the hills", to quote Ontario Securities Commission Commissioner, Derek Brown, in the OSC Hearing on YBM Magnex International Inc.

Independent directors need to be protected from being terminated or voted out and personally sued, due to their whistleblowing function on behalf of existing shareholders and public investors, generally. Once the investigation order is promptly put into place, ie., within 20 days of the independent director's complaint, independent directors should receive immunity from lawsuits claiming unfounded

complaints, defamation or interference with economic relations arising from their co-operation with the securities regulators. Protecting the independent director is tantamount to protecting the public interest, because it is the independent director's function to be a front-line gatekeeper representing the interests of shareowners. If independent directors are not protected from the reprisals of executives and the company involved in the securities violations, then independent directors would simply walk and not co-operate with the securities regulators in investigations and the implementation of enforcement actions.

After an investigation order is in place, majority directors and majority shareowners should not be permitted to vote out or otherwise take any legal steps to terminate an independent director. Any independent director who is forced out or resigns within a reasonable time period before or after the investigation order should be interviewed by the provincial securities commission enforcement division to determine if they have "headed for the hills." There should be no changes made in cash payments of any kind made to directors or other insiders during a reasonable period before and after an investigation order, which arose from a director's complaint. Public investors should not bear the brunt of securities violations and future public disclosure of these violations, while insiders walk with ill-gotten financial gains.

One Point of Contact for Enforcement Process

I would like to address the matter of why it is essential to have one set of securities rules and one point of contact for the enforcement process in Canada. Most of the media coverage and most opinions on this matter from officials of the exchanges, provincial securities commissions, the investment banking industry and public corporations have been from the perspective of simplification of securities regulation for the issuer. I believe one set of securities rules and one enforcement process is essential for investors, as well. My own personal experience as an independent director of a public company, who tried to stop securities violations, is that the current fragmented system of securities laws and enforcement make it virtually impossible for independent directors to do their job. Most securities violations cross the provincial borders, and likely also cross the Canadian-U.S. border. The provincial securities commissions and other law enforcement agencies do not co-operate well with each other in investigations and enforcement. Acknowledged securities violations are left without consequence, when one provincial securities commission sanctions the violations in its jurisdiction, and has no duty to sanction other securities violations that are in another provincial securities commission's jurisdiction.

The resources and funding for the enforcement divisions at thirteen provincial securities commissions are not efficient and effective. The consequence is that a smaller fraction of securities violations is detected and a smaller fraction of those caught receive sanctions for all their securities improprieties.

New Securities Administrative Court

I recommend a specialized a new securities administrative court, comprising the current provincial securities commissioners as administrative judges. Provincial securities commissions have the authority to investigate and to implement sanctions for securities non-compliance based on the public interest. Until Bill 198 gave the Ontario Securities Commission the power to provide restitution for investor losses in April 2003, private investors throughout Canada had to obtain restitution for investment losses through civil litigation. Ideally, investors would prefer that there would be one place where the securities violations would be adjudicated and proven. The second step in the process would then become restitution for investor losses determined by the same securities administrative court, before expert administrative judges.

The way the process works now is that investors usually complain first to the provincial securities commissions. Then, they wait and hope that the provincial

securities commissions will intervene. The provincial securities commission's policy will be to not inform the complainants about what it intends to do. So, the complainant never knows whether the provincial securities commission has decided to do nothing or whether it is simply taking up to six years to decide what to do. The complainant can wait for the provincial securities commission to decide whether there is a securities violation and then start civil litigation. Or, he can start the litigation earlier and try to use the courts to prove the securities violation. Even the OSC Chairman and the OSC Head of Enforcement have said that the OSC staff tends not to utilize the Ontario courts for implementation of prosecutions for securities violations, because the judges do not have the expertise on securities law that the OSC has.

In civil litigation, the issuers, and insiders acting jointly or in concert with them, can utilize the limited expertise of court judges and the fragmented securities legislation and enforcement procedures to their advantage. Investors who seek provincial securities commission intervention for different securities crimes must have multiple complaints in the different provinces according to which province has jurisdiction for enforcement of the specific securities violation. The defendants are able to obtain stays of civil litigation by making arguments of duplicity, abuse of process, and frivolous and vexatious for having made complaints to the provincial securities commissions, especially if more than one is involved. Also, the provincial securities commissions, who choose not to do an enforcement action on an acknowledged violation, can use arguments of it being an abuse of process for them to enforce the provincial securities act because there is already civil litigation going on. The uncertainty of timing and the legal ricocheting between civil actions and provincial securities commission enforcement actions is an investor's nightmare.

It is virtually impossible for individual investors to obtain justice in the courts due to the high cost of civil litigation in this fragmented system of securities law. It is especially so when there is such an unpredictable outcome in the court due to lack of securities expertise and a history of the courts not treating securities violations seriously. Court judges often rely on the provincial securities commissions to adjudicate on securities violations, since this is their area of expertise. It is time for the public legislators of Canada to recognize this fact and to create one new securities administrative court comprising provincial securities commissioners as expert administrative judges.

The Securities Administrative Court Must Charge Reasonable Fees for Individual Investors

It is inappropriate that only those who can afford justice are able to pursue court and provincial securities commission remedies for securities law non-compliance. The new securities administrative court must be affordable and welcoming to individual investors. The provincial securities commissions are crown administrative tribunals who should be obtaining justice for all investors, regardless of their financial means. The complaints process for individual investors is free, however it is a process that is not transparent. The various provincial securities commissions have published the criteria that they use for determining public interest and committing limited enforcement resources to a specific case. The provincial securities commissions do not, however, routinely communicate in writing which public interest criteria did not get met when an enforcement file is closed. If shareholders and the investing public do not agree with a provincial securities commission staff decision to ignore an acknowledged securities violation, there has to be an affordable mechanism for the public to have these non-transparent enforcement decisions scrutinized for their integrity. It should not be that only those who can afford a $7,500 application fee for a review of a provincial securities commission enforcement staff decision get one. Every member of the investing public deserves the right for an affordable review process by a quorum of provincial securities commissioners of the provincial securities commission staff's enforcement work. It is particularly important to have an affordable review when the criteria used to reject specific cases for investigation is not transparent to the public.

Conclusions

I make the above recommendations on the basis of my professional expertise and personal experience as an independent director of a public company. The current securities regulatory and judicial system in Canada is telling individual investors that there is too much risk investing in Canadian equities. There is securities enforcement risk and an unaffordable process for restitution of their investment losses. This regulatory risk is outside of their control, and is added to the business and market risk in their investment portfolios. I would like the Wise Persons Committee to adopt my recommendations so that individual investors can have greater confidence in the enforcement responsibilities of the independent directors and securities commissions. These individual investors also need to know that there is a simple and affordable process for them to seek restitution for their investment losses caused by securities violations.

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