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Monica Kowal
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Dear Ms. Kowal:

You have asked us to provide you with our opinion with respect to the following question:

Under the *Securities Act*, and any other applicable law, what are the legal responsibilities of the Board of Directors of the Ontario Securities Commission in relation to the Enforcement Branch and are the Commission's internal policies and practices in conflict with the fulfillment of these responsibilities?

Conclusion

In our opinion,

1. the Board of Directors of the Ontario Securities Commission is under an obligation to "oversee the management of the financial and other affairs of the Commission";
2. this obligation extends to the Enforcement Branch of the Commission;
3. the Commission's internal policies and practices are consistent with the Board's oversight obligation; and

4. the policies and practices enable the Board of Directors of the Commission to satisfy its obligations to “oversee the management of the Enforcement Branch of the Commission.”

Introduction

The question arises as a result of statements in the *Report of the Fairness Committee to the Ontario Securities Commission* (March 5, 2004) (the “Report”). Section 2 of the Report describes the structure and operations of the OSC. In Section 3 of the Report, the Committee notes (at 15-16) (emphasis added):

The Commission, in order to ensure that the adjudicative function is free from an attack based on a perception of bias, reasonably apprehended or actual, has gone to great lengths to create a partition between Enforcement and Commissioners. The Chair, as the chief executive officer, is the exception. The Chair takes an active role in *overseeing* Enforcement and its major cases, both before and after the issuance of a notice of hearing. This structure has led to a malfunctioning of the Commission. Enforcement, which is one of the most important branches, operates on its own without priorities, policies or practices being subjected to the Commissioners’ advice and *oversight*. Enforcement has been described as a ‘black hole’ within the Commission.

The Committee then goes on to state that the “absence of involvement on the part of the Commissioners as a whole” is a concern from a legal perspective. This concern is based on the fact that “the Commissioners are the board of directors of the Commission...with the responsibility of overseeing the management of the financial and other affairs of the Commission”, which includes the enforcement branch. The Committee goes on to state that the oversight cannot be delegated to the chief executive officer. At p. 49 of the Report, the Committee states (emphasis added):

While the internal walls between the Commissioners and Enforcement may meet the common law’s condemnation of inappropriately overlapping functions, there may, however, be countervailing difficulties. This is particularly so *if* they have the effect of removing Commissioners from the effective supervision of the enforcement branch. Given the Commissioners’ responsibilities as directors of the corporation, default in the exercise of their supervisory role may violate the law.

August 11, 2004

- 3 -

Ontario Securities Commission

Presumably, the Committee is concerned that the present arrangements, described in the above quotations, constitute a delegation of the responsibility to oversee enforcement to the Chair; hence, the legal concern.

The Report goes on to observe that this legal concern could be obviated by removing the adjudicative function from the Commission, which would remove the concerns about bias and obviate the need for the partition between enforcement and the Commissioners. "The Commissioners as a whole would be entitled to take a hands-on approach to the establishment of enforcement priorities, practices (including a protocol to govern the settlement process) and planning."

To answer the question set out at the beginning of this letter, we have reviewed: the Report, the *Securities Act*, the by-laws of the Commission, selected minutes of Commission meetings and other materials provided to us by the then Acting General Counsel and by the Secretary to the Commission. We also met with representatives of the Enforcement Branch, including the Director of Enforcement. We begin our analysis with a review of the relevant provisions of the Act and the Commission's by-laws. We then consider whether the internal structure of the Commission, particularly the alleged "partition between Enforcement and Commissioners" and the role played by the Chair is a fact and, if so, whether it gives rise to a legal problem.

Relevant Provisions of the Act and By-laws

The Ontario Securities Commission is a statutory corporation which has been continued by the *Securities Act* (the "Act") (s.3). As a statutory corporation, its powers and its organization is subject to the strictures imposed by the Act (and other relevant legislation).

Section 3(2) of the Act calls for at least 9 and not more than 14 members. Pursuant to s.3.1(1) of the Act, the Commission must have a board of directors and the board is composed of the members of the Commission. Section 3.1(2) of the Act provides that the board of directors "shall oversee the management of the financial and other affairs of the Commission." Under s.3.2(2) of the Act, the Commission is made responsible "for the administration of this Act and shall perform the duties assigned to it under this Act or any other Act."

The Commission is empowered to enact by-laws on a variety of matters. The by-laws must be approved by the Minister (as that term is defined in s.1 of the *Securities Act*). By virtue of s.3.2(3) the Commission may make by-laws:

- (a) governing the administration, management and conduct of the affairs of the Commission;

....

(g) governing the appointment, operation or dissolution of committees of the board of directors and delegating duties of the board to the committees.

As we have pointed out, s.3.1(2) of the Act provides that the board “shall oversee the management of the financial and other affairs” of the Commission.

Section 2.1.3 of the Act provides that “[e]ffective and responsive securities regulation requires timely, open and efficient administration and enforcement of this Act by the Commission.” Section 3.2(2) states that the “Commission is responsible for the administration of this Act and shall perform the duties assigned to it under this Act and any other Act.” Subsection (3)(d) of s.3.2 gives the Commission the power to enact by-laws “delegating to employees of the Commission the exercise or performance of any power or duty conferred or imposed on an officer of the Commission under this Act.” Section 3.2(3)(c) allows the Commission to make by-laws setting out the powers, functions and duties of each Vice-Chair and the officers employed by the Commission. The term “officer” is defined in s.1 of the Act.

Section 3.6(1) of the Act provides that the Commission “may employ such persons as it considers necessary to enable it effectively to perform its duties and exercise its powers under this or any other Act.” Subsection (2) authorizes the Commission to appoint an Executive Director and a Secretary as officers and to appoint such other officers as it considers necessary.

Section 3.5(4) of the Act recognizes that the potential for conflict may arise where a Commissioner is involved in the investigation function and then adjudicates on that matter. The Commission has established a number of protections to reduce the potential for apprehension of bias. These protections are recognized in the Report and are evident from the material that we have reviewed.

Enforcement is addressed in Part XXII of the Act. The Commission’s powers with respect to enforcement include (i) consenting to prosecutions under s.122 (s.122(7)), (ii) making interim preservation orders (s.126), (iii) making public interest orders (s.127), (iv) making cost orders (s.127.1), and (v) making court applications under ss.128, 129, etc.

The Board’s Oversight Obligation

In order to determine whether the criticism of the Fairness Committee regarding oversight of enforcement is justified, it is important to determine what the oversight obligation entails. Oversight by a board of directors does not entail day-to-day management of the financial or any other affairs of the Commission. Responsibility for day-to-day management of a corporation, including a statutory corporation, resides with management of the corporation, not the board of directors. A board’s “oversight” role entails “watching over” the operations of the corporation. In our opinion, this is equally true in the case of the

board's responsibility to oversee the enforcement activities of the Commission. The board's role is not to manage the Commission's enforcement operations but to oversee those operations, by setting priorities and policies, and ensuring that appropriate management is in place and adequately monitored. If the board does not oversee enforcement in this sense, then, subject to the board's power to delegate this responsibility to the Chair, the board would not be fulfilling its statutory obligation.

Good corporate governance generally requires the board of a corporation to ensure the strategic guidance of the entity, effective monitoring of management by the board and the board's accountability to its shareholders or, in the case of the Commission, the Minister of Finance of Ontario or such other member of the Executive Council to whom the administration of this Act may be assigned. Effective monitoring of management requires that the information necessary to meet this obligation is provided to the board so that the board can determine whether management's actions are consistent with the strategic goals set by the board.

If determining whether the Board of the Commission is overseeing the enforcement activities of the Commission is measured by corporate governance standards, it is difficult to see why the internal structure adopted by the Commission to meet concerns about bias does not meet those standards. The Board is not, nor is it expected to be, responsible for the day-to-day management of enforcement activities. As long as the Board is apprised of enforcement activities and is able to determine whether the activities are consistent with the policies established by the Commission, then it cannot be said to have abdicated its oversight responsibility.

The Commission's Structure and the Board's Oversight Responsibility

Just as the legislative scheme of the OSC and other securities commissions has protected the commissions from attacks based on an appearance of bias, so, in our opinion, there is also a good argument that the structure of the OSC justifies a somewhat different approach to corporate governance. In *Brosseau v. Alberta Securities Commission*, [1989] 1 S.C.R. 301, the court stated:

If a certain degree of overlapping of functions is authorized by statute, then, to the extent that it is authorized, it will *not generally* be subject to the doctrine of "reasonable apprehension of bias" *per se*.

While the structure of the Commission cannot be the basis of a challenge for bias, it is clear that the actions of the Commission in a particular case could be subject to a challenge for bias.

August 11, 2004

- 6 -

Ontario Securities Commission

The Act itself contains provisions to minimize claims of bias. For example, s.3.5(4) of the Act provides that a member who exercises a power or performs a duty of the Commission under Part VI except s.17 in respect of a matter under investigation cannot sit in a hearing by the Commission that deals with the matter except with the consent of all the parties.

The Actions of the Board

In our opinion it is clear that the Commission has not delegated responsibility of enforcement to the Chair. Our review of board meeting minutes clearly shows that the Commission regularly reviews enforcement issues. While we are not privy to all the enforcement issues that arise from day-to-day, the minutes do show process due care is being taken by the Commission.

We are of the opinion that the information with respect to enforcement matters provided to the board of directors is more than adequate to enable the board to fulfil its oversight responsibilities. First, the board establishes enforcement priorities, conducts an extensive review of enforcement activities and reviews and approves the annual business plan and budget of the Commission. Second, staff make frequent presentations to the board on specific issues related to investigation and enforcement. These presentations are sometimes initiated by staff and sometimes requested by the board, and the board has an opportunity to respond to staff presentations, to provide its views on enforcement matters to staff and to provide general directions with respect to enforcement issues. Third, board agendas are developed by the Chair, often with the input of staff from the Enforcement Branch to keep the board informed of current issues relating to enforcement. Fourth, the Director of Enforcement attends weekly Executive Management Team meetings at which enforcement activities are discussed. Information from these sessions is provided to the Chair, who in turn reports to the board regularly, including on matters relating to enforcement (although not with respect to individual cases).

Conclusion

In our opinion, the *Securities Act* imposes responsibility to oversee enforcement on the board of the Commission. Our review shows that the Commission's internal procedures are used to ensure that the Enforcement Branch provides the board with the information necessary to enable the Commission to fulfil its oversight responsibilities in respect of the

August 11, 2004

- 7 -

Ontario Securities Commission

Enforcement Branch. Based on the information provided to us, we are of the opinion that the Commission's internal structures do not in any way conflict with the board's responsibilities regarding enforcement.

Yours very truly,

McCarthy Tétrault LLP