APPENDIX

FORSTROM JACKSON

BARRISTERS AND SOLICITORS*

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VIA E-MAIL

British Columbia Securities Commission
701 West Georgia Street
PO Box 10142
Vancouver, BC
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Attention: Brent Aitken, Vice-Chair

Dear Brent:

Re: BCN 2007/27 BCSC Governance of Enforcement Settlement Agreements

The BC Securities Commission recently published BCN 2007/27 (the "Notice") that describes a new process for management of enforcement settlement agreements. This letter contains my comments on the Notice. I urge the Commission to delay implementation beyond October 1, 2007 until such time as a fulsome discussion may be had with market participants and their counsel.

The exclusion of respondents from the Review Committee hearing is a disincentive to settlement
The Notice discloses that a committee of Commissioners (the "Committee") will review the proposed settlement with staff and the executive director and would authorize the executive director to proceed with the settlement within certain parameters. There is no indication in the Notice as to what point in the settlement process this review by the Committee would take place. What is clear is that neither the Respondent nor counsel will participate in this review. Respectfully I would suggest that failure to include respondents, particularly after negotiations are underway between respondents and Staff, may lead to an unfairness and lack of due process or at the very least a perception thereof. Permitting respondents to participate fully in the settlement process provides the transparency, flexibility and cost effectiveness that the Commission identified as its goals.

Staff and the ED will have the Committee's impressions of the case while the Respondent will have to rely upon Staff's interpretation of the Committee's position as reported to the respondent by Commission staff after the Committee has met with staff.

The Notice suggests that within the context of the review, Committee members may ask any questions they think are relevant. Respondents will be prevented from providing their answer or position to the

Committee's questions and again will be precluded from receiving notice of the Committee's questions and its opinions.

Participation in the Committee's review itself can be a useful tool in a respondent's analysis of the strengths or weakness of the case against them in the same way a judicial settlement conference can provide an independent third party's impression of the case. If the case does not settle, information obtained through the settlement process including the review committee hearing, is a useful tool and may contribute to the manner in which a case is advanced through a hearing. This process will be unavailable to respondents under the mechanism proposed in the Notice.

The wording of the Notice is that the Committee will review "the proposed settlement". This suggests that the Committee will be given a settlement upon which staff and the respondent have come to some agreement as amongst themselves. The Notice then suggests that the Committee will then give staff and the ED the "parameters" under which settlement can be reached. This opens up the settlement discussion again, again without input from the respondent. This is confusing and suggests an approval mechanism missing one party, the Respondent.

Removing the respondent from the settlement process will not achieve the goals of

- Preservation of the ability to include creative and flexible terms in settlements: the flexibility cannot be achieved when one party is missing.
- not impose costs (in money or time) that exceed the benefits it adds: additional costs will be required if the parties must go back to the drawing table once the Committee has provided its parameters
- not create unintended consequences (for example, disincentives to settle). Respondents will take no comfort that an in camera meeting assessing the settlement is held between the Committee and its own staff. This is a significant disincentive to settlement. In most ex parte proceedings, the person against whom the order is made has the opportunity on short notice to appear before the tribunal or court to provide its position. The process outlined in the Notice provides no such mechanism.

The new settlement process raises questions

From the above you will see that I disagree with this new process or perhaps misunderstand it. On its surface the process has the appearance of unfairness, a lack of due process and opens up the process to allegations of bias even where no such bias exists. The process raises more questions than it answers, including:

- At what point is the Respondent removed from the settlement process such that staff then seeks the equivalent of an *ex parte* hearing before this Committee?
- Who determines when the Committee is struck?
- What evidence about the reasons for the settlement proposal will the Committee receive and from whom?
- Are respondents required to rely upon staff to present the their position on the settlement to the Committee?

- When the Committee members ask questions, they only receive staff's answer. Who gives the Respondent's answers?
- Who has access to the Committee's parameters other than staff and the ED?
- How, where and when is the decision of the Committee on the parameters recorded?
- Are their transcripts of the hearing before the Committee and will the Respondent have access to those transcripts?
- Once the Committee gives its parameters and staff presumably enters another settlement agreement or continues with existing discussions with the Respondent, will staff be required to appear one more time before the Committee for another ex parte hearing?
- What if the Respondent disagrees with the parameters? Is settlement impossible or can another proposal be but before the Committee?

I am aware of no other Canadian securities commission or securities regulator that avails itself of the process proposed by the Notice. Perhaps the most important feature of a settlement is that the Respondent comes away with the view that there has been fairness to the process and transparency, neither of which exist when one of the parties is excluded from the process.

Thank you for the opportunity to provide my views on this subject which is of critical importance to the regulatory environment in which our clients and Commission Staff operate. I look forward to a further opportunity to canvass these issues with the Commission.

Yours truly,

FORSTROM JACKSON
Per:

Patricia Taylor, Associate Counsel

PT

cc: Lang Evans, Enforcement Director BCSC
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September 16, 2007

BY EMAIL: baitken@bcsc.bc.ca

Mr. Brent W. Aitken
Vice Chair
British Columbia Securities Commission
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Dear Mr. Aitken,

Re: BCN 2007/27: BCSC Governance of Enforcement Settlement Agreements

This letter responds to the request for comments in the Commission's Notice 2007/27 (the "Notice") concerning its proposed new system for review and approval of enforcement settlement agreements. As described in the Notice, the primary reason for proposing a new settlement approval system is to enhance the Commission's oversight of its settlement process by imposing a more intensive governance mechanism that would apply to individual settlements. The Notice expresses the Commission's conclusion that the proposed system will accomplish these goals without impeding the ability to achieve creative and flexible terms in settlements, imposing excessive costs or delays on the process, or creating any disincentives to settlement on the part of persons responding to allegations made by the Commission's enforcement staff ("Enforcement Staff").

The Notice states that in the course of its deliberations, the Commission seriously considered and rejected a settlement approval process like the one followed by the Ontario Securities Commission ("OSC"), the Investment Dealers Association of Canada ("IDA"), the Mutual Fund Dealers Association of Canada ("MFDA") and Market Regulation Services Inc. ("RS"). It appears, as well, to have considered the procedures followed by the United States Securities and Exchange Commission ("SEC") with respect to approval of settlements, including the recent change in SEC practice for settlements involving a monetary penalty against a corporate issuer.

The Commission's proposed system follows neither, but adopts elements of both. In result, it raises questions of fairness to persons negotiating a settlement with Enforcement Staff by involving, or appearing to involve, Commission members in the settlement negotiation process and it would not create an optimum governance mechanism for oversight of individual settlements or the settlement process.

Current Commission Practice

The Commission's current practice leaves the negotiation of settlements of regulatory and potential regulatory proceedings to the Executive Director and other Enforcement Staff. In general terms, settlements are negotiated by Enforcement Staff under the supervision of the Executive Director who signs the settlement agreement and issues any order that is required under the *Securities Act* (the "Act") to implement it. The Executive Director generally consults with the Commission's Chair "before completing a novel or significant settlement," but the Commission does not approve individual settlements. Only settlements made with a respondent after a hearing has commenced are considered individually by members of the Commission; in such cases, the members of the Commission hearing the matter as an adjudicative panel are required to approve the settlement. The Commission oversees the settlement process by reviewing concluded settlements on a monthly basis and communicating policy matters that should be considered in future settlements to the Executive Director through the Chair.

Proposed New System

The system outlined in the Notice would change this practice by requiring approval of proposed settlements on an individual basis by a quorum of commissioners. The Notice states that the proposed system is intended as "a governance not an adjudicative process" and characterizes the commissioners who would consider a proposed settlement as a "committee of the board, not as a hearing panel." Prior to entering into a settlement agreement, the Executive Director and Enforcement Staff would meet with a committee of commissioners to obtain authorization to proceed with the settlement "within certain parameters". The commissioners would be entitled to ask any questions they think relevant. If subsequent to obtaining authorization, negotiations continue and issues arise that go outside the approved parameters, the Executive Director would ask the committee to reconvene to consider a change in the parameters.

Commissioners who participate in this process would not discuss the matter with any other commissioner and if a settlement does not result, would be disqualified from sitting on a hearing of the matter without the consent of the parties. The proposed system would apply to all enforcement settlements, including those reached after a hearing has begun. The Notice does not state whether the monthly review of settlements currently conducted by the Commission would continue or be replaced by the proposed system.

Comments

Although the Notice states that the proposed system is a governance process and calls participating commissioners "committees of the board", the function that these commissioners will perform is essentially an adjudicative function. The commissioners' consideration of a proposed settlement will focus on the facts presented by the Executive Director and Enforcement Staff, the facts that the other party is prepared to admit or agree to, the terms of any proposed order or undertaking, and the adequacy of the proposed remedies, in light of the policies of the Act and the commissioners' view of the public interest. While the commissioners may take into

account consistency of a particular settlement with prior settlements, their focus will inevitably be on the facts and circumstances relating to the respondent and the matter under consideration. In other words, the focus of their considerations will be individualized, a hallmark of an adjudicative, as opposed to a broader policy, determination; see, e.g., P. Anisman, *A Catalogue of Discretionary Powers in the Revised Statutes of Canada 1970* (LRCC 1975), pp. 9-11. In short, whether called "committees" or "panels", the function of commissioners who consider and approve the terms or parameters of individual settlements will, in substance, be no different than an adjudicative decision, even though it will not determine one result but a result within acceptable parameters, subject to further negotiation by Enforcement Staff. This is essentially the type of decision made by OSC, IDA, MFDA and RS panels when considering whether to accept a signed settlement agreement; see, e.g., *In re Eugene N. Melnyk*, (2007) 30 O.S.C.B. 5253 (June 8), pp. 5255-56; *In re Sohan Singh Koonar*, (2002) 25 O.S.C.B. 2691 (May 10), p. 2692; *In re Edward Richard Milewski*, (1999) 22 O.S.C.B. 5404 (August 27), p. 5407 (IDA).

However the system is characterized, the fact that the commissioners will meet only with the Executive Director and Enforcement Staff, without the respondent being represented, is troublesome. Although Enforcement Staff will undoubtedly attempt to present a balanced approach to commissioners, they may not have the same knowledge of the facts and will not have the same perspective as the respondent.

One of the goals of the proposed system is to preserve the ability to include "flexible and creative terms" in settlements. Flexible and creative terms in settlements are often the result of proposals made by counsel for a respondent, rather than by Enforcement Staff. In any event, they usually reflect discussion and compromise between the parties. Aspects of a novel resolution to a matter that might cause concern to a commissioner may be more fully addressed if counsel for a respondent is present. This has been the case in some settlement approval hearings before the OSC.

An opportunity for a respondent to address the commissioners' questions or concerns is important, as the consequences of a determination of the commissioners would not be negligible for a respondent, despite the statement in the Notice to the contrary. A decision of the commissioners may set parameters that a respondent cannot meet or believes to be unfair or otherwise inappropriate. Meetings of such commissioners with the Executive Director and Enforcement Staff without the presence of respondent's counsel will affect the dynamics of negotiations between Enforcement Staff and the respondent. If during a settlement negotiation the Executive Director can obtain the views of a quorum of commissioners on the terms being negotiated, with the Executive Director having to return to the commissioners only after subsequent negotiations go beyond the approved parameters, the negotiating ability of the respondent will inevitably be diminished. In fact, the SEC's new pre-approval procedure for settlements against corporations contemplates this result, as it is intended to give SEC staff "the strongest negotiating position"; C. Cox, "Address to the Mutual Fund Directors Forum - Seventh Annual Policy Conference," April 13, 2007, http://www.sec.gov/news/speech/2007/spch041207cc.htm. The proposed process thus has the potential to reduce the confidence of respondents in the settlement process by involving the commissioners in Enforcement Staff's negotiations, albeit indirectly.

In emphasizing its intention to "provide sound governance over the settlement process", the Notice suggests, without expressly stating, that the proposed system would allow commissioners to address proposed settlements in light of broader Commission policy. But hearings before a quorum of two or three commissioners are not the most effective manner of overseeing the settlement process from a policy perspective. Such oversight requires consideration by the full Commission of trends in settlements, as well as issues arising out of individual cases. This may be achieved by the Commission's monthly review of settlements. Put simply, the efficiency and effectiveness of the Commission's settlement process and policy concerns arising out of settlements and their terms are best considered by the full Commission.

This understanding is reflected in the SEC's practice with approval of settlements. The SEC must approve settlements before they proceed. All five SEC commissioners participate in these decisions. They also participate in the new settlement pre-approval process (which is similar to the Commission's proposed system) that was adopted by the SEC in April, 2007 for the "handful of cases" that might involve the imposition of a monetary penalty against a corporation. In this limited category of cases, the SEC must approve settlement parameters before settlement negotiations begin, and the final approval process after a settlement agreement has been reached is a summary one.

The settlement procedure adopted by the SEC does not provide a model that would generally be acceptable in Canada, at least with respect to matters that may proceed to an administrative hearing on which the same commissioners sit, because of the potential for prejudgment; see generally, e.g., Anisman, "The Ontario Securities Commission as Regulator: Adjudication, Fairness and Accountability," in A.I. Anand and W.F. Flanagan, eds., *Conflicts of Interest in Capital Market Structures: Queens Annual Business Law Symposium* 101 (2003); *cf.* C.A. Osborne, D.J. Mullan and B. Finlay, *Report of the Fairness Committee to the Ontario Securities Commission* (March 5, 2004). This is acknowledged in the Notice, which states that commissioners sitting on "settlement committees" would not discuss the matter with other commissioners and would be disqualified from sitting on a hearing of the same matter.

A Suggested Oversight Process

The optimum governance system for Commission oversight of its regulatory settlement process should involve both approval of individual settlements by Commission panels and ongoing review by the full Commission of settlements that have been approved or rejected and of the trends they reflect, in light of the policies of the Act and Commission policy on sanctions, remedies and other issues involving the public interest.

The Commission should adopt a system requiring review of each settlement by a panel of commissioners to determine whether its terms come within acceptable parameters, recognizing that the settlement process requires some flexibility and often creativity in reaching an agreement between Enforcement Staff and a respondent. At a hearing to consider approval of a settlement, the panel should be entitled to request any additional information and ask any questions they think are relevant. This is the general approach taken by the OSC, IDA, MFDA and RS. (The MFDA's rules permit disclosure of facts that are not contained in a settlement agreement only if the parties consent; MFDA Rules of Procedure, Rule 15.3.) Such hearings have the advantages

of not involving members of the Commission or regulatory panels in the negotiation process, of giving a respondent an opportunity to appear and respond to any concerns a panel may have, and of providing assurance that the terms of settlements are satisfactory from a policy and/or public interest perspective. The Executive Director will remain able to consult with the Commission's Chair about settlements being negotiated, provided that the Chair does not discuss them with other commissioners or sit on settlement approval or other hearings concerning a matter on which he has been consulted.

Participation by commissioners in such hearings would also assist the Commission in conducting its oversight function with respect to broader issues relating to the settlement process, including the development of guidelines concerning settlements, if the Commission concludes that guidelines would be advisable. The Commission might also consider adopting guidelines that permit some settlements for which Commission approval is not required, as now occurs in Ontario on occasion, in cases where the conduct in question is less reprehensible or does not require an order of the type that should be considered by the Commission; see Anisman, "The OSC as Regulator," pp. 138-39. If such settlements are permitted, they too would be subject to oversight in the reviews conducted by the full Commission.

1. Settlement Approval Hearing

Although it is not required, the general practice of the OSC, the IDA and RS is to give public notice of settlement approval hearings. (The MFDA's rules require public notice.) OSC panels, although not required to do so, generally agree to hold the hearing of submissions *in camera* and to reopen the hearing after an agreement is approved; see, e.g., *OSC Practice Guidelines - Settlement Procedures in Matters Before the Ontario Securities Commission*, paras. 5(5) and 5(6). The IDA bylaws do not require a settlement approval hearing to be open to the public until after a settlement agreement has been accepted by the hearing panel; see IDA, By-laws, s. 20.55(1)(a). This practice is necessary to ensure basic fairness to respondents, as settlement agreements provide that admissions or agreement as to facts may not be used against the respondent in a subsequent proceeding and will remain confidential, if the settlement is not approved. As a result, the OSC and IDA generally hold a closed hearing and release the settlement agreement along with an order approving it. (Although its rules also contemplate this practice, RS usually requires a respondent to agree to the full hearing being conducted openly.) If the Commission accepts this submission, it should, at a minimum, adopt the practice of the OSC and IDA in a rule or guideline relating to settlement hearings.

If a settlement is not approved by a panel, the OSC and IDA will maintain the settlement agreement and hearing transcript in confidence. In all cases, including RS, any admissions or facts agreed to in a settlement agreement may not be relied on in a subsequent hearing of the matter, should a second settlement not be reached. In the few cases in which the OSC has rejected settlements, the OSC's staff and the parties have returned to the OSC with a revised settlement that received Commission approval. This result is not surprising, in part because the fact of the initial agreement, although not its terms, was made public by notice of the approval hearing.

Notice of an approval hearing may have an unfair impact on a respondent who agrees to a settlement, as it makes public the fact that the respondent has admitted some form of culpable conduct that was at least contrary to the public interest. This creates a public impression of guilt and may add to any harm to the respondent's reputation caused by previously published allegations, especially if the settlement is rejected. It will certainly do so if a settlement agreement is reached before Enforcement Staff publish a notice of hearing and allegations. Moreover, the fact of the settlement agreement and its rejection will be known to the panel that subsequently hears the matter on its merits. For these reasons, the Commission should consider adopting a requirement that settlement approval hearings be held *in camera*, without public notice. This would avoid unfairness to a respondent whose settlement is rejected. Transparency of the process can, and should, be assured by publishing an approved settlement agreement with the related order, and if the settlement is rejected, by making the agreement, the transcripts of the hearing and the panel's reasons for rejecting the settlement publicly available after a further settlement has been approved or after a hearing on the merits has been held and a final decision rendered.

If a settlement is rejected, the hearing panel should be required to provide reasons for the rejection to the parties orally or in writing, as the panel determines. Any such reasons, by explaining why the proposed settlement was rejected, would suggest parameters within which the panel might find a settlement acceptable. On the basis of such reasons, further negotiations may be pursued by Enforcement Staff and the respondent with a view to achieving an acceptable settlement. If a revised settlement is reached, the same panel should be convened to consider its approval. This is the OSC's practice; see *OSC Practice Guidelines - Settlement Procedures,* para. 6; see also, e.g., McFarland, "OSC rejects Melnyk deal," The Globe and Mail, Report on Business, May 9, 2007, p. B3; *In re Eugene N. Melnyk*, above (reasons for approving revised settlement). (The IDA's bylaws require that a new hearing panel be convened for a subsequent settlement hearing, but that it be given the first panel's reasons; IDA, By-laws, s. 20.38.) Having the same panel continue to hear the matter is more efficient, as the panel members are already familiar with the facts. It would also avoid the possibility that a second panel might apply different standards to the matter. This assumes some importance when it is recognized that Enforcement Staff, having agreed to the terms of a settlement that has been rejected, will ordinarily find it difficult to vary from them in a significant way.

This approval process should be followed in all cases, except where a hearing has commenced. Once a hearing has commenced and evidence has been heard, the hearing panel will be familiar with the facts of the case. The hearing panel will therefore be in a better position than a fresh panel to assess the adequacy of a settlement between Enforcement Staff and a respondent. (However, if one of several respondents agrees to settle after a hearing has begun, the hearing panel should be entitled to consider the settlement only with the consent of all parties to the proceeding, unless the settling party will be called as a witness in the proceeding.) If a settlement is reached prior to introduction of any evidence, the hearing panel would be like a panel convened to consider any settlement agreement, but would have the benefit of its pre-hearing preparation. In this case, the hearing panel should conduct the approval hearing on the understanding that it will recuse itself, if it rejects the settlement.

This suggested settlement approval procedure would have the advantages of the system proposed by the Commission with the additional benefit of giving respondents an opportunity to be heard. It would thus ensure fairness to respondents, avoid adverse publicity prior to approval, retain the ability to include flexible and creative terms in settlements and carry less risk of unintended consequences (that might result from involving members of the Commission in the negotiating process) than the system proposed by the Commission, without creating greater costs or delay for Enforcement Staff than the proposed system. An approval process of this nature will rarely, if ever, create a disincentive to a settlement, as the pressures and other factors that influence a respondent's willingness to settle will be present whether or not Commission approval is required. While a formal approval process might create additional legal costs for some respondents and may impose additional costs on the Commission, these costs will be balanced by the opportunity the respondents would have to be heard by the commissioners considering the settlement and the fairness and transparency of the system.

2. Oversight by Full Commission

Regular review by the full Commission would take into account the number of settlements agreed to by the Executive Director that were rejected and would be able to consider the reasons for rejection after completion of the matter through a further settlement or a hearing on the merits. This would permit fuller oversight of the settlement process by the full Commission and would facilitate the development and publication of guidelines to assist Enforcement Staff and market participants.

In addition, as part of its own accountability, the Commission should publish an annual or semi-annual summary disclosing the number of settlements approved and rejected, the general terms of such settlements and the Commission's assessment of the settlement process.

Conclusion

The modifications to the proposed system that are suggested in this letter are not dramatic. A system involving *in camera* approval hearings to consider settlements agreed to by the Executive Director will accomplish all of the goals identified in the Notice and will also provide greater fairness to respondents both in the negotiating process and before the commissioners who consider a proposed settlement.

If you wish to discuss any of the issues raised by this letter, I shall be pleased to do so.

Yours respectfully,

"Philip Anisman"

Philip Anisman

cc: Doug Hyndman, Chair, British Columbia Securities Commission
cc: David Wilson, Chair, Ontario Securities Commission