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Sent Via <http://www.sec.gov/rules/proposed.shtml>

U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington D.C. 20549-1090

Attention: Brent J. Fields, Secretary

**Re: File No. S7-12-15  
Release Nos. 33-9861; 34-75342, IC-31702  
Listing Standards for Recovery of Erroneously Awarded Compensation**

Ladies and Gentlemen:

We are submitting this comment letter in response to the Securities and Exchange Commission's (the "Commission") proposed rule on Listing Standards for Recovery of Erroneously Awarded Compensation (the "Proposed Rule"). The Proposed Rule and related form amendments would implement the provisions of Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which added Section 10D to the Securities Exchange Act of 1934. Section 10D requires the Commission to adopt rules and regulations directing the national securities exchanges and national securities associations to prohibit the listing of any security of an issuing company that is not in compliance with Section 10D's requirement to disclose the company's policy on incentive-based compensation and the recovery of any incentive-based compensation received by an executive officer that is in excess of what would have been received under an accounting restatement.

Our firm has offices in both Canada and the United States and represents a number of "foreign private issuers" with securities listed on a national securities exchange or national securities association, including the New York Stock Exchange (NYSE) and National Association of Securities Dealers Automated Quotations (Nasdaq). We are submitting this comment letter on behalf of our clients, including a large Canadian federally-regulated financial institution ("Canadian Financial Institution") whose securities are listed on the NYSE, as well as on the Toronto Stock Exchange (TSX). Our Canadian Financial Institution client is subject to extensive federal regulatory oversight in Canada by the Office of the Superintendent of Financial Institutions (OSFI). Like many of our clients, it is

subject to continuous disclosure reporting obligations under Canadian securities laws, regulations and rules and the listing requirements of the TSX and are also subject to those U.S. continuous disclosure reporting obligations and NYSE listing standards applicable to foreign private issuers. We and our clients appreciate the opportunity to comment on the Proposed Rules.

## **Executive Summary**

We respectfully submit that foreign private issuers domiciled in Canada need greater flexibility in making determinations respecting the application and enforcement of clawback provisions to executive officers and disclosing their conclusions on the application of their clawback policies to executive officers than is contemplated in the Proposed Rule. As further detailed below, we submit that:

- the Commission should recognize that home country law related to compensation clawbacks includes the common law as it may develop over time;
- it is neither appropriate nor practical to seek to limit an exemption based on home country law in effect or as interpreted as of the date the Proposed Rule was published in the Federal Register or as of any future date as the interpretation and the application of home country law to different circumstances develops over time;
- foreign private issuers should be permitted to adopt clawback arrangements that apply solely to compensation awarded or earned subsequent to the date the issuer has adopted a clawback policy which conforms to the Proposed Rule as finalized by the Commission to avoid risks, including potential damage awards against the issuer, associated with making fundamental or significant changes to existing employment arrangements;
- it is impractical to require delivery of a legal opinion as a condition to forgoing recovery of compensation, and potentially disadvantageous to the foreign private issuer's compensation recovery efforts. Investor interests are adequately served by the proposed requirement to disclose the extent to which the foreign private issuer has been successful (or not) in effecting compensation recovery<sup>1</sup>;

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<sup>1</sup> In the event the Commission determines to keep the requirement that a legal opinion be delivered, in adopting the final rule the Commission should provide guidance or an instruction to the final rule as to the level of opinion "comfort" required with regard to illegality and, in particular, that a "will violate" or even a "would likely violate" level of opinion comfort is not required.

- For global companies with employees located in multiple jurisdictions, the concept of home country law in the final rule should be expanded to cover the local law of the jurisdiction where an executive officer covered by the final rule is employed, and not just the law of the issuer's home country, as such local law will also potentially govern the employee/employer relationship; and
- the Commission should provide that calculation of the recovery amount is to be determined by the issuer in its reasonable judgment after consideration of all relevant circumstances and, in any event, an issuer should not be required to deliver documentation regarding its determination to the relevant exchange.

## **Canadian Financial Institutions Are Already Subject to Regulatory Rules on Compensation Recovery**

For several years, our Canadian financial institution clients have been subject to substantive compensation recovery requirements and almost all of our TSX listed clients have been subject to Canadian compensation recovery disclosure requirements.

OSFI requires financial institutions to comply with the Financial Stability Board's 2009 Principles for Sound Compensation Practices and Implementation Standards. These state that reduced financial performance should lead to reduced total variable compensation, taking into account both current compensation and reductions in payouts of amounts previously earned, including through malus or clawback arrangements.

Further, under Canadian securities laws, almost all of our TSX listed clients are required to provide executive compensation disclosure in accordance with National Instrument 51-102 Continuous Disclosure Obligations and, in particular, as prescribed by Form 51-102F6. Under Form 51-102F6, our clients are required, among other things, to disclose in the compensation discussion and analysis included in their annual proxy circular:

- any practices the company uses to identify and mitigate compensation policies and practices that could encourage a named executive officer or individual at a principal business unit or division to take inappropriate or excessive risks; and
- policies and decisions about the adjustment or recovery of awards, earnings, payments, or payables if the performance goal or similar condition on which they are based are restated or adjusted to reduce the award, earning, payment or payable.

Consistent with these requirements, our clients annually disclose that their executive officers can be required to forfeit outstanding incentive awards and repay compensation that has already been paid if there is a financial restatement, excessive risk-taking or inappropriate conduct resulting in significant losses, fines or penalties. These clawback

arrangements apply to short term incentives, payouts from deferred compensation arrangements and equity based compensation.

## **Violation of Home Country Law Requirements of Proposed Rule**

The Proposed Rule contemplates that foreign private issuers would be permitted to forgo recovery if recovery would violate applicable home country law, but only if the home country law was in effect prior to the date the Proposed Rule was published in the Federal Register and only if the issuer has obtained and provided to the U.S. exchange a legal opinion from home country counsel that recovery would violate home country law and such opinion is acceptable to the U.S. exchange. We respectfully submit this exemptive provision as written fails to appropriately recognize as matters of comity Canadian common law and statutory developments and requirements. It also fails to take into consideration the application of the laws of jurisdictions outside the home country which apply to employees of our clients who work internationally. Moreover, as set out in more detail below, the requirement to deliver a legal opinion as a condition to forgoing recovery of compensation is impractical and potentially disadvantageous to the foreign private issuer and its compensation recovery efforts.

## **Enforceability of Compensation Recovery Arrangements Under Canadian Laws**

There is no statutory provision in Canada requiring employers to include clawback provisions in employment contracts or to establish clawback policies. As a result, the enforceability of clawback provisions will depend on interpretation of the terms of the employee/employer employment arrangement. The terms the employee/employer employment arrangement are governed by a mixture of:

- statutory laws, including applicable federal, provincial or territorial employment standards legislation, depending on the jurisdiction governing the employment relationship;
- common law, as developed by Canadian courts;<sup>2</sup> and
- contractual provisions, which may be written, oral or based on developed practice. Canadian law does not recognize the concept of “employment at will”, instead all

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<sup>2</sup> In this connection we note that Proposed Rule 10D-1(b)(iv) specifically states that “the home country law must have been *adopted* in such home country prior to the date of publication in the Federal Register of proposed Rule 10D-1.” [Emphasis added] Use of the term “adopted” could suggest that only home country statutory provisions are contemplated under the Proposed Rule as only statutes are “adopted” and would thus not allow consideration of home country common law. Use of the term “adopted” also suggests a static, individual point in time which may not allow for continuing jurisprudence to develop as to how an existing statute is to be interpreted under different factual scenarios. For the reasons hereafter discussed we do not believe that such limitations are intended or appropriate.

Canadian employees are employed pursuant to an employment contract. This contract contains both express terms as well as implied terms, and in all cases needs to conform to the applicable statutory requirements.

As discussed in more detail below, the enforceability of clawback arrangements is a developing area in Canadian jurisprudence, where decisions reflect individual facts and circumstances rather than broad principles.

### *Enforceability of Clawbacks in Canada Under Contract and Common Law*

There is a little Canadian caselaw on the enforceability of clawback provisions, and what little caselaw exists has focused on the application of clawbacks for breach of non-competition covenants.

Canadian courts have taken varying approaches to the enforceability of a clawback for breach of a non-competition covenant. For example, the Quebec Court of Appeal in *Deghenghi v. Ayerst, McKenna & Harrison Ltd.*, [1998] J.Q. no 1252 (C.A.) concluded that a clause in a management incentive plan making a distribution thereunder conditional upon non-competition should be treated as a non-compete covenant and, applying the tests for such covenants under Quebec law, was unenforceable. By contrast, in *Woodward v Stelco Inc.*, [1998] 80 CPR (3d) 319 (Stelco) the Ontario Court of Appeal ruled that a promise not to compete in exchange for continued payment of supplementary executive retirement benefits was not a contract in restraint of trade, and therefore the common law requirements of reasonableness did not apply. The court's rationale was that the promise not to compete did not restrain trade because the executive could have competed, except that by doing so he would lose the right to the supplementary retirement benefits.

The Stelco decision was extended in *Nortel Networks v Jervis* [2002], 33 CPB 71, OJ No. 12 (QL) (Ont Sup Ct) (Nortel) where another Ontario court enforced a non-competition promise in connection with stock option awards. In Nortel, the court concluded that requiring the employee to disgorge his profit from the exercise of the stock options, following the terms of his signed option agreement, upon taking up work with a competitor did constitute a penalty, but not one which was oppressive in the circumstances.

Last year, the British Columbia Court of Appeal in *Rhebergen v. Creston Veterinary Clinic Ltd.*, [2014] BCCA 97 explicitly rejected the Ontario approach described in Nortel and adopted a hybrid or "functionalist" approach requiring the court to look to the effect of the provision to determine if the burden on the former employee has the effect of constituting a restraint of trade and, if it does, the common law requirements of reasonableness must be satisfied.

It is relevant to note in all of the above cases, express provisions relating to forfeiture were included in written agreements signed by the employee. We are not aware of any Canadian decision permitting clawback of compensation pursuant to a policy adopted by the employer. It is also worth noting that in all of these cases, the clawback was triggered by an act taken by the employee in contravention of the express provision. By contrast, the Proposed Rule contemplates recoupment of compensation from all executive officers as a result of a financial restatement, even in the absence of any fraud or misconduct, or knowledge thereof, by an executive officer.

As home country common law is not a static body of precedent and develops, often slowly, over time, it may in the future be interpreted by courts in the employment area to apply under certain factual situations to limit or find unenforceable clawback provisions contemplated by the Proposed Rule. As a result, we respectfully submit that in crafting the final rule, the Commission specifically acknowledge that home country law specifically includes the common law as it may develop over time and that such common law is not limited to that in effect or as interpreted as of the date the Proposed Rule was published in the Federal Register or as of any future date.

### *Enforceability of Clawbacks in Canada Under Employment Standards Legislation*

Other than statutory withholding requirements, such as those in respect of income tax and Canada Pension Plan and Employment Insurance contributions, employment standards legislation typically prohibits deductions from earnings unless the amount being deducted has been authorized in writing by the employee. What constitutes “earnings” that are prohibited from deduction varies across the federal, provincial and territorial jurisdictions in Canada. However, typically the scope of earnings that are prohibited from deduction is very broad and likely would cover many forms of incentive compensation. Moreover there are limitations that define what constitutes a lawful deduction authorization; for example, the federal employment standards legislation, the *Canada Labour Code* (the “**Labour Code**”), prohibits the employer from making a deduction based on a written authorization in respect of “loss of money or property, if any person other than the employee has access to the property or money in question.” The federal Labour Program – the governmental entity responsible for enforcing the Labour Code – also takes the position that, in order to be valid, written authorizations must “specify a particular sum, and be given in a way that is truly consensual”. As such, according to the Labour Program, general blanket authorizations – with or without specific amounts – can operate to assign responsibility or liability to the employee, but in order to actually clawback any amount from an employee’s earnings the “written authorization must be obtained after the fact, i.e., after the incident or transaction to which it is related has occurred”. Other Canadian jurisdictions take differing approaches on whether the authorization must specify a precise amount as opposed to precise formula. We note that none of the cases cited earlier addressed employment standards legislation matters.

Accordingly, even in the case of existing statutory law, we respectfully urge the Commission in finalizing the Proposed Rule to allow for the development of jurisprudence in this area, including as to whether or not statutory provisions in effect as of any specific date are applicable.

More generally, we would further recommend to the Commission that the final rule not contain any limitation as to the date the law is adopted. In this connection, we respectfully submit that such a limitation is an improper intrusion by the Commission into the laws, and public policy determinations, of a sovereign nation.<sup>3</sup> Moreover, such a limitation of the exemptive relief set forth in the Proposed Rule does not prohibit a foreign sovereign jurisdiction from adopting a law in the future that prohibits clawback recovery policies generally or under specific conditions. If such a law were to be adopted in the future, we submit that a foreign private issuer which has experienced a financial restatement should not be required to choose between violating its home country law (or the laws of other jurisdictions in the case of its international employees) or violating the Commission's final rule and related exchange rule and thus face potential delisting.

### *Other Employment Law Implications of Clawback Provisions*

As noted above, in Canada, in contrast to the United States, there is no employment "at will", and all employment relationships (whether or not a written contract exists) are deemed contractual. When an employer makes a fundamental or significant change to an essential term of an employee's terms and/or conditions of employment without notice, the employee may choose to treat the employment relationship as terminated and the employer will be liable for damages in lieu of reasonable notice. These damages can be quite substantial and it is not unusual for very senior executives to be awarded between 18 and 24 months total compensation (salary, incentive compensation, benefits, etc.). As the application of a clawback provision to compensation awarded or earned prior to the adoption of the clawback provision might in some circumstances constitute a fundamental or significant change, clawback provisions are typically adopted by Canadian issuers to apply solely with respect to compensation earned subsequent to the adoption. For the same reason, we recommend that the Commission in finalizing the Proposed Rule adopt a similar approach and only require foreign private issuers to adopt clawback arrangements that apply to compensation awarded or earned subsequent to the date the issuer has adopted a clawback policy which conforms to the Proposed Rule as finalized by the Commission,

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<sup>3</sup> In the proposing release, the Commission states that the proposal to set a limitation as to the date the home country law is adopted is intended to minimize any incentive countries may have to change their laws in response to the provision. See Proposing Release at pages 69-70.

rather than requiring that recoupment apply to compensation that is granted, earned or vested on or after the effective date of Rule 10D-1.<sup>4</sup>

## **Requirement to Deliver a Legal Opinion**

As noted above, the Proposed Rule contemplates that foreign private issuers would be permitted to forgo recovery if recovery would violate applicable home country law, but only if the home country law was in effect prior to the date the Proposed Rule was published in the Federal Register and only if the issuer has obtained and provided to the U.S. exchange a legal opinion from home country counsel that recovery would violate home country law and such opinion is acceptable to the U.S. exchange.

The proposal to make availability of an exemption from the application of the Proposed Rule conditional upon delivery of a legal opinion is, we submit, a novel and unusual approach.<sup>5</sup>

The delivery of a legal opinion to a U.S. exchange that recovery of compensation would violate a foreign private issuer's home country law, as it existed on the date of the Proposed Rule was published or as the home country law existed on any other date, in some or all circumstances, could be extremely disadvantageous to the issuer and its shareholders. Even if the opinion were to be delivered to the exchange in confidence and the exchange undertook to maintain confidentiality, it would not be possible to protect against the subsequent disclosure of the opinion in any legal proceedings between the foreign private issuer and an executive officer whose compensation is subject to clawback pursuant to a policy adopted pursuant to the Proposed Rule. As delivery of the opinion would be voluntary and not compelled by statute, the foreign private issuer would not be entitled to assert privilege over its disclosure or production in such proceedings under Canadian law as the disclosure to the exchange would waive any applicable attorney-client privilege. Unless the opinion concludes that all prospects for recovery will violate home country law, disclosure of the opinion could compromise efforts of foreign private issuers to recoup incentive compensation where recovery or certain means of recovery is possible but not assured if any such opinion became available to an executive officer.

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<sup>4</sup> Proposed Rule 10D-1(a)(2)(ii).

<sup>5</sup> For example, NASDAQ Listing Rule 5615(a)(3) requires delivery of a written statement from an independent counsel in a foreign private issuer's home country certifying that the Company's corporate governance practices are not prohibited by the home country's laws. But it does not condition the availability of the exemption from compliance with NASDAQ corporate governance requirements on delivery of an opinion that compliance would violate home country law.



Accordingly, we submit that in finalizing the Proposed Rule, the Commission should eliminate the requirement that a legal opinion be delivered to the applicable exchange.

Even if the Commission determines to require delivery of a written legal opinion to the applicable exchange, the Commission should consider that the standard of comfort for an opinion can vary widely, including “better view”, “should” or “would likely” comfort levels. The absence of developed caselaw regarding compensation clawbacks in Canada adversely affects the level of comfort an opinion giver can provide. For the delivery of an opinion to be a condition to availability of the exemption, additional guidance would be needed on what comfort level is sufficient and should be acceptable to the U.S. exchange. In this connection, we submit that a requirement for a “will violate” opinion regarding home country law (or unenforceability of the clawback provision), or even a “would likely” standard, is not the appropriate standard and that the Commission when finalizing the Proposed Rule provide an instruction to that effect.

For all of the foregoing reasons, we submit that the requirement to deliver a legal opinion as a condition to forgoing recovery of compensation is impractical, and potentially disadvantageous to the foreign private issuer’s compensation recovery efforts and, therefore, not in the best interests of its shareholders. Instead, foreign private issuers should be permitted greater flexibility to forgo recovery. Investor interests are adequately served by the proposed requirement to disclose the extent to which the foreign private issuer has been successful (or not) in effecting compensation recovery. Many of our clients provide their shareholders with an annual say on pay vote – which affords their shareholders who are dissatisfied with the compensation recovery efforts an opportunity to express their dissatisfaction through such vote.

## **Calculation of the Recoverable Amount**

There is general support for the principle that recovery should be with respect to “the amount of incentive-based compensation received by the executive officer or former executive officer that exceeds the amount of incentive-based compensation that otherwise would have been received had it been determined based on the accounting restatement.” However, there are many practical challenges in calculating the “recoverable amount” under the Proposed Rule.

Incentive compensation award amounts are rarely a function of a formulaic calculation that would make recalculation of amounts possible without the exercise of judgement and estimation. Incentive compensation awards may be granted or paid based on a variety of corporate and individual performance measures, not all of which will be assigned specific weightings. As recognized by the Commission in the proposing release, determining the recoverable amount is especially challenging in incentive-based compensation that is based on stock price or total shareholder return, but the challenge is not limited to such

circumstances. Flexibility is needed for the issuer to reach its conclusions on the recoverable amount. For this reason, our clients' policies give discretion to make such determinations to the issuer and it is left up to the issuer to determine the extent to which documentation is needed in support of its determination. We submit that there is a similar need to rely on the reasonable judgement of a foreign private issuer in determining the recoverable amount and any supporting documentation for its determination. We further submit that it should not be necessary to provide any supporting documentation for the issuer's determinations to the relevant exchange.

We thank you again for the opportunity to comment on the Proposed Rule and respectfully request that the Commission consider our recommendations and suggestions in finalizing the listing standards rule. James Lurie and Andrew MacDougall are available to meet and discuss these matters with the Commission and its staff, and to respond to any questions.

Yours truly,

*Osler, Hoskin & Harcourt LLP*

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