Chartered Accountants of Canada

20 Questions Directors Should Ask about **Special Committees**

Second edition

WRITTEN BY
William K. Orr and Aaron J. Atkinson

20 QUESTIONS

How to use this publication

Each “20 Questions” briefing is designed to be a concise, easy-to-read introduction to an issue of importance to directors. The question format reflects the oversight role of directors which includes asking management — and themselves — tough questions.

The questions are not intended to be a precise checklist, but rather a way to provide insight and stimulate discussion on important topics. The comments that accompany the questions provide directors with a basis for critically assessing the answers they get and digging deeper as necessary.

The comments summarize current thinking on the issues and the practices of leading organizations. Although the questions apply to most medium to large organizations, the answers will vary according to the size, complexity and sophistication of each individual organization.

WRITTEN BY
William K. Orr and Aaron J. Atkinson

PROJECT DIRECTION
Gigi Dawe
Principal, Risk Oversight and Governance
CICA

Rayna Shienfield, J.D.
Principal, Risk Oversight and Governance
CICA

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Preface

The Risk Oversight and Governance Board (ROGB) of the Canadian Institute of Chartered Accountants (CICA) has developed this publication to help boards of directors when the need for a special committee arises.

Special committees, established on an *ad hoc* basis, are used by directors as a procedural decision making tool to deliver recommendations to the board. Such committees are often established in a short period of time and under increased tension within the organization. However, it is essential that the committee is properly established and empowered and carries out an appropriate committee process.

While there is no one set of rules that apply to all situations, there are general principles that can help guide directors in this task. This publication outlines the preliminary matters to consider in establishing a special committee, as well as its establishment and organization. It describes the committee's duties and liabilities, and the establishment of an appropriate process to aid the board and special committee in undertaking this task.

The ROGB acknowledges and thanks the members of the Directors Advisory Group for their invaluable advice, the authors William K. Orr and Aaron J. Atkinson and the CICA staff who provided support for the project.

Huw Thomas, CA
Chair, Risk Oversight and Governance Board

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Introduction

In an era of increasing regulation, public scrutiny and economic turbulence, serving as a public company director presents many challenges. Satisfying all potential constituencies likely to question or challenge a board decision may seem practically impossible. The challenge is particularly acute where a decision involves the company's reputation or long-term future, such as when allegations of internal wrongdoing surface or the company is under attack from a hostile take-over suitor. A board can expect to have its decisions in these circumstances closely examined by the press, analysts and investors, governance commentators, proxy advisors and, in some cases, regulators and the courts.

While public opinion of board decisions is subject to countless influences, directors in Canada can take comfort from the fact that, from a legal perspective, courts generally will not second-guess a board's business judgment provided that its decision is reasonable and was made free of conflicts with the benefit of impartial advice. With the benefit of hindsight, outside observers may well, and perhaps rightly, criticize a board's decision; however, a court's focus is on the *process* by which the decision was made rather than whether the decision itself was the "correct" or "best" one.

A board is therefore well-advised to ensure that the process by which its decision is reached is carried out with proper rigour and independence. A common procedural tool recognized by courts to do so is to establish an *ad hoc* special committee of unconflicted directors to conduct a detailed review of the issues and deliver a recommendation to the board.

Deceptively simple in concept, the task of properly establishing and empowering a committee and carrying out an appropriate committee process involves the exercise of a substantial amount of judgment in an often truncated time period where tensions already may be heightened within the organization. While a number of "best practices" have developed over time to assist a special committee in discharging its duties, some practices may be unfamiliar to an organization and can give rise to conflict or misunderstandings.

These practices begin with ensuring there is a written mandate appropriate in scope that properly empowers the committee to conduct its deliberations independently. The committee's mandate is its "playbook", the key standard against which it will be judged, and itself a source of potential tension. A properly empowered committee is generally authorized to retain outside legal and other advisors, potentially at significant cost, which can impact the corporate budgeting process. A committee is also generally given control over its meeting protocol and other procedural matters, often carrying out key deliberations alone with its advisors to maintain the independence of its decision-making process. Consequently, such a process may exclude some of the organization's customary decision-makers, such as executive management or other board members, who are accustomed to being present for key deliberations and who may well question the wisdom of such a process. Accordingly, a properly functioning committee needs to ensure that its process not only conforms to applicable legal standards, but also addresses the political and practical issues that may arise within the organization.

Given the varied nature of special committees and the circumstances in which they are established, it is not possible to provide one set of rules or guidelines to be equally applied in all cases. The following discussion is designed to provide some general principles, as well as some practical insight, to guide directors in Canada in navigating through the process of establishing a committee and conducting a committee process appropriate for the task at hand.

Part I – Preliminary Matters

1. Why should a board establish a special committee?

In very few cases does Canadian law expressly mandate that a special committee be established; however, by implication of existing jurisprudence and prevailing governance norms, a board is often well-advised to precede a significant board decision with a review process undertaken by a special committee of independent directors.

A special committee is often established where a board decision raises a concern about potential conflicts of interest. In these circumstances, the establishment of a special committee of independent directors is intended as a procedural safeguard to ensure any decision is made by individuals whose judgment will be unclouded by ancillary interests or considerations. A decision made in this way will carry significant weight with a court in determining whether a board has exercised appropriate "business judgment".

In other cases, a board may feel that, due to the significance of the decision and the time-frame in which it must be made, a smaller group of directors should undertake an intensive review that the full board would be unable to conduct in the circumstances. In this way, the board ensures that a detailed review is completed efficiently and is freed from the practical constraints of corralling the full board for several meetings in a short time-frame.

Some of the more common circumstances in which a board may choose to establish a special committee include the following:

- Where a company is facing a potential change of control transaction, whether by way of an unsolicited take-over offer or an auction process, a board will typically establish a special committee comprised of non-management directors independent of significant shareholders to evaluate offers and consider alternatives and appropriate defensive measures. Boards often choose to establish a special committee in change of control scenarios, even in the absence of a hostile bidder or an auction, such as in the case of a friendly transaction with a strategic buyer. Such a committee can be expected to ensure an impartial evaluation of the merits of any particular transaction, taking into account affected stakeholder interests.

- A board may determine that an evaluation of strategic alternatives is necessary. These alternatives may include a significant change in the direction of the business, or a recapitalization, reorganization or sale of the company. In these circumstances, the board may wish to appoint a special committee of directors to evaluate these alternatives with the assistance of senior management and, potentially, outside financial and legal advisors. A committee in these circumstances can be expected to face many of the same issues as a committee established to consider a change of control transaction.
- Where a transaction involves a related party to the organization, such as in a management buy-out, a board will establish a special committee of directors independent of the related party to negotiate on behalf of the organization. In these circumstances, the committee can be expected to attempt to ensure, to the extent possible, an "arm's length" bargaining process is conducted.
- A board may learn of allegations of potential wrongdoing within the company. Depending

on the circumstances, the board may direct an existing standing committee, such as the audit committee, to investigate the allegations or may establish a special committee for this purpose. A committee conducting such an investigation must do so in a confidential and independent manner to ensure the integrity of the investigation.
- A board may delegate to a special committee the task of reviewing performance issues concerning executive management, including where the board may be losing confidence in one or more key members of executive management. A committee in these circumstances will need to ensure its independence from management and carefully consider succession issues.
- An organization may be approached by one or more shareholders who are seeking changes to the board, management or other changes to the organization or its business practices. The board may appoint a committee in these circumstances to evaluate the merits of the changes being sought and to liaise with the shareholder or group seeking change.

In other circumstances, such as where the board is a manageable size, no particular board member has an identifiable expertise for the proposed task of a committee, and, perhaps most importantly, all board members are free of conflicts, the entire board may desire to undertake the proposed mandate of the committee.

When determining whether to establish a special committee, the board of a public company should also consider other factors, including whether the establishment of the committee itself needs to be disclosed or, as discussed below, when the existence of the committee or fees paid to committee members may require disclosure in the company's regular continuous disclosure filings. Among other considerations, such disclosure could give rise to unwarranted speculation among investors and analysts.

A board also must consider that establishing a special committee generally results in additional cost to the organization. For example, as discussed below, committee members generally should receive additional compensation due to the additional time and effort demanded of the committee members over and above their regular board duties. An appropriate committee process also typically requires that the committee be empowered to retain, at the expense of the company, independent legal, financial or other outside expert advisors to assist the committee in discharging its mandate.

2. How does a special committee process assist the board in discharging its duties?

Given the potential for both legal and other scrutiny, any significant board decision should generally be preceded by a process that includes an investigation of the facts giving rise to the need for a decision, an evaluation of the long-term interests of the corporation, and the identification and consideration of the reasonable expectations of stakeholders affected by the decision. Any such process is less likely to be challenged if it is undertaken by a committee of disinterested directors who undertake a proper and independent review, with the assistance of outside experts.

a) Directors' Duties

A comprehensive discussion of directors' duties in Canada is beyond the scope of this discussion, so the following provides a necessarily brief summary of key principles that govern directors' actions in Canada.

A board of directors of a corporation has a statutory duty to manage or supervise the management of the business and affairs of the corporation. The directors owe two principal duties to the corporation that govern their obligations in all circumstances:

- a duty of care – directors must exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances; and
- a fiduciary duty of loyalty – directors must act honestly and in good faith with a view to the best interests of the corporation.

For many years, in part due to the influence of United States jurisprudence, the directors' duty of loyalty was generally viewed as serving the best interests of the shareholders as a whole on the basis that shareholders had entrusted the board with the supervision of the corporation's affairs. The Supreme Court of Canada subsequently clarified that the fiduciary duty is owed to the corporation and not to shareholders or any other stakeholder.

Furthermore, there is no general overriding principle that one set of interests, such as the interests of shareholders, should prevail over the interests of any other stakeholders. Accordingly, the board's fiduciary duty is not confined to short-term profit or share value, but is directed instead at the corporation's long-term interests which may vary depending on the specific facts faced by the directors and requires an assessment of affected stakeholder interests.

In making any decision, the board must identify and consider the impact of its decision on the reasonable expectations of all affected stakeholders, which may include, among others, security holders, creditors, employees, the local community, customers and suppliers. Where the interests of stakeholders conflict, the board must exercise its business judgment to resolve those conflicts in a fair and balanced way, recognizing that there is no general principle that dictates when one particular stakeholder should be favoured over another. The appropriate response by directors to any particular situation is a function of their business judgment of what is in the best interests of the corporation in the particular situation faced by the corporation.

b) Business Judgment Rule

In carrying out their duties, directors are expected to act prudently and on a reasonably informed basis. While a high degree of diligence is demanded, the standard is less than perfection. Where a director's decision is a reasonable one in light of all the circumstances about which the director knew or ought to have known, courts will not interfere with that decision. The court's inquiry will generally focus on whether the directors applied an appropriate degree of prudence and diligence in reaching their decisions. The foregoing is also known as the "business judgment rule" and has been strongly endorsed by the Supreme Court of Canada.

c) Delegation of Authority

Subject to certain specific exceptions, Canadian corporate law generally permits directors to delegate powers to a committee of directors; however, the fact that a board delegates the review of a potential decision to a special committee does not absolve the board of further responsibility for that decision. In particular, the board must maintain a reasonable amount of supervision over the committee's activities. Typically, the board carries out this function by ensuring that the committee reports to it periodically. During these updates, the board can provide guidance and input into the committee's process. Of course, the board also must ensure that it does not unduly interfere in the workings of the committee and therefore taint the independence of the committee's process.

3. Does a director assume added liability by serving on a special committee?

A committee member is not subject to additional legal liability over and above the liability to which a director is subject in other circumstances. Provided an appropriate review process is carried out, a director may take comfort from the protections afforded by the business judgment rule.

In establishing a committee, the board looks to the committee members to undertake a proper review process that will serve to justify the decision ultimately made by the board. As a result, the board maintains a duty to supervise the committee while the committee takes on the role that otherwise would be carried out by the full board. To the extent the board reasonably relies on the committee and exercises appropriate supervision, the committee members take on distinct responsibility not shared by the other board members; however, this responsibility does not heighten the legal standard against which the committee members will be judged. As they would with respect to any board decision, the committee members must take their role seriously and most often will want to retain independent experts and advisors to assist in discharging its mandate so that its decision may gain the protection of the business judgment rule.

While a director may be shielded from legal liability regarding a particular decision, that decision may nevertheless be subject to criticism from outside observers. In particular, committee members should consider that their actions could be subject to review by shareholders at the time of the company's next or subsequent annual meetings. With the prevalence of majority voting policies, it is conceivable that shareholders or influential proxy advisory firms could express concern over actions of the committee by withholding, or recommending withholding, votes for committee members in subsequent director elections.

Part II – Establishment and Organization

4. When should a board establish a special committee?

While the potential benefits of incorporating a special committee review into a board decision-making process should be clear, a competing concern is that a board must exercise care in determining when to establish a committee. On the one hand, a board may want to ensure that a committee is not established prematurely given the potential additional costs involved and potential disclosure issues. A competing consideration is that the committee not be established at a point in the process where alternatives are limited or, in hindsight, the ultimate recommendation of the board is perceived as having been a foregone conclusion. Like many board decisions, it is a matter of judgment as to when a committee should be established, but the following are some considerations that may be helpful in guiding the decision:

- What are the actual and potential conflicts involved in making the decision and when are they expected to arise?
- What is the likelihood that a decision will have to be made and what is the time-frame in which a decision is required?
- How significant is the potential transaction and what are the implications of the decision on the organization's various stakeholders?

5. What is the committee's mandate?

The mere fact that a board has established a committee that undertakes a review process will not in itself shield a board from criticism or potential legal liability. As noted earlier, the committee's mandate is its "playbook" and the key standard against which it will be judged. Accordingly, a committee process carried out with a limited mandate where a broader mandate is warranted is more likely to be criticized and could be successfully challenged in court, even in circumstances where the committee has acted as if its mandate was broader. In this case, the text of the mandate matters.

Best practices dictate that the committee be established by a board-approved written mandate with a clear articulation of (i) the tasks to be delegated, (ii) the committee's authority to discharge those tasks and establish its operating procedures, and (iii) the compensation payable to committee members. Given its importance, a board is well-advised to have outside legal counsel review the committee's mandate to ensure that it is consistent with prevailing governance practices.

A clear mandate adopted at the outset of the committee's work will clarify the committee's duties and will reduce the possibility of disputes later in the process, including with regard to the scope of the committee's activities. In addition, the board will have a clear understanding of which tasks remain for consideration by the full board. In some circumstances, committee members may wish to take an expanded view of their mandated powers.

The findings and recommendations of the committee may be less susceptible to criticism if the committee has been sufficiently empowered. For example, if a committee is charged with the task of conducting an internal investigation but does not have the expertise or time to undertake a forensic investigation itself, the committee should be empowered to retain appropriate outside advisors to assist.

A typical special committee mandate in the M&A context includes the following tasks: (i) considering alternatives available to the company; (ii) considering a canvass of the market and/or solicitation of other proposals; (iii) reviewing proposals; (iv) negotiating or supervising the negotiations of proposals; and (v) making a recommendation to the board. A sample mandate in this context is attached as Appendix "A".

A mandate for a committee established to conduct an internal investigation will have a different focus, including the power to obtain and review internal company records and to determine whether and when public disclosure is necessary. A sample mandate in this context is attached as Appendix "B".

6. Who should serve on a special committee?

While the prevailing consideration in selecting a committee member should be the individual's independence, the board also should take into

account a number of other factors, including the individual's expertise for the task at hand, the availability of the individual to devote the necessary time to participate meaningfully, and the ability of the committee members to work together as a group.

a) Independence

A key to evaluating any committee process is to ensure that the decision at issue is made, and perceived to be made, on the merits, unclouded by outside considerations. As a consequence, all members of a special committee should be free of competing interests that could reasonably be viewed as adversely impacting their judgment. In making this assessment, a perception that outside interests could affect the judgment of a committee member can be as important as the existence of an actual conflict. The importance of any particular outside interest or relationship will depend on the matter under review by the committee.

As a result, consideration of the various technical legal definitions of independence should not be the end of the inquiry. Prospective committee members should disclose any relationships or outside interests that may reasonably give rise to potential conflicts. Conflicts may arise on a number of levels, including in business, professional or family relationships. Deliberations concerning potential conflicts should be documented for the record and, in some cases, may need to be publicly disclosed and explained. In many cases, it may be appropriate to disclose certain relationships that were considered by the board, together with the board's reasons for determining that the director's independence was not compromised.

As a result of various regulatory and judicial pronouncements as well as prevailing governance practices, in certain circumstances, certain relationships preclude board members from serving. While there can be no doubt that executive management usually have the best understanding of the day-to-day operations of the organization, an executive who is also a director should not serve on a special committee given the executive's inherent conflict as an employee of the organization. While a committee should generally consult with management where its expertise is needed, management should be excluded from the decision-making process.

As another example, a board member who is a representative of a substantial shareholder may need to be excluded to overcome any suggestion that the shareholder's interest was favoured over those of other stakeholders. In one notable example, a committee established in connection with a take-over bid was found not to be independent where the committee included, as an active participant, the president and chief executive officer of the company and, as an observer and resource, a representative of a shareholder holding 50% of the votes.

In some circumstances, it is possible that directors who are independent for one purpose might be conflicted in other circumstances. For example, where a committee has been established to undertake an investigation of accounting irregularities then, depending on the nature of the allegations, it may be appropriate to exclude members of the audit committee to the extent that the issues call into question activities of the audit committee.

b) Expertise and Experience

While independence is a prime consideration in establishing committee membership, it is perhaps equally important to ensure that those on the committee will apply the appropriate degree of rigour and analysis to the matter under review. A board will typically have a mix of experience and expertise, potentially including industry experts, financial experts, those with prior executive management experience and individuals with academic, legal or capital markets credentials. Depending on the mandate of the committee, certain directors' experience profile may be more suited than others to the matter under review.

On occasion, simply having prior experience of serving on a special committee may be a relevant consideration. The experience of a director who has previously navigated through the pitfalls, political challenges and public scrutiny of a committee process, from selecting and managing advisors to managing various stakeholder expectations, can itself be worthwhile to complement substantive expertise on the committee.

c) Time Commitment and Other Factors

Membership on a special committee invariably requires a director to devote a significant amount of time to attend meetings, engage with advisors

and to review substantial materials, often in a very truncated time period and often with short notice. As a result, a director may be otherwise well-qualified to serve on a committee, but due to his or her travel schedule or other commitments, it may be inappropriate for the director to serve on the committee. Notwithstanding a director's exclusion from the committee in these circumstances, it may be appropriate for the individual to participate in the committee's process as time allows so that the committee may benefit from his or her experience.

While legal and governance norms in large part dictate who should serve on a committee, the working dynamic of the committee is a factor that should not be ignored given that the board will be relying on the committee to function cohesively in a potentially high-pressure situation. A board should not ignore the fact that all directors are human, each with his or her own character traits, leadership qualities and approach to decision-making.

One key factor in considering the committee's decision-making dynamic is who will serve as committee chair. While this is often an issue best left to the committee to determine, it may be appropriate for the board to select the chair at the outset, particularly where there may be more than one member who would prefer the role. While the committee's process, as a general rule, should be independent and dictated by the committee, it is appropriate for the board, in exercising its supervisory authority, to take steps to ensure that the committee process will function smoothly.

7. What factors are considered in assessing the independence of a committee member?

The concept of "independence" in the context of an *ad hoc* special committee is inherently fact-specific. As discussed earlier, in certain circumstances, the law or prevailing governance practices may automatically preclude an individual from being considered to be independent. More generally, the board must apply reasonable judgment in assessing whether a relationship between a director and the organization, management, shareholders or others should disqualify the director from serving on the special committee.

The key is to consider whether the committee member's judgment could be impaired, or, perhaps more importantly, reasonably challenged, as a result of a particular relationship. Given the potential breadth of the inquiry and the relatively small size of Canada's public markets, it is possible that every director on a given board will have outside business or other relationships to consider. Canadian courts have recognized that any potential conflict of interest must be balanced against the reasonable benefit to be obtained by appointing a specific individual to serve on the committee.

In addition to the foregoing general principles, additional guidance in the analysis can be found in other sources:

- Most Canadian public companies engaged in transactions involving related parties will be subject to special rules (the "Special Transaction Rules"). The stated purpose of these rules is to ensure procedural fairness by prescribing additional procedural safeguards in transactions capable of being abusive or unfair. These transactions include those where an inequality in the knowledge of the affairs of a company is presumed to exist between the public shareholders and other parties to the transaction, such as in the case of an insider who has nominees on the board and who is seeking to acquire the interest of the public shareholders.
- Under the Special Transaction Rules, certain relationships automatically disqualify a board member from serving as an independent director, including if the director was recently employed by, or has a significant equity interest in, a party to the transaction. While the Special Transaction Rules apply only to specific types of transactions involving public companies, the relationships enumerated in those rules are indicative of the types of relationships that should be considered in all cases.
- In addition to the Special Transaction Rules, directors also should consider the corporate governance guidelines published by the Canadian securities regulators (the "Guidelines"). The Guidelines provide recommended best practices for public companies and include recommendations regarding the proportion of independent directors that should serve on a board and certain standing board committees, in addition to prescribing certain relationships that automatically disqualify a board member from being considered independent. While the Guidelines do not specifically address membership on *ad hoc* special committees, the types of

relationships described by the Guidelines should be considered carefully when evaluating the independence of prospective special committee members.

Making any decision about a director's independence ultimately involves the exercise of judgment in applying the foregoing guidance to a particular set of facts. For example, where a committee is established to review a proposed transaction with a significant shareholder, the board must consider any material relationships between board members and the significant shareholder. While casual social relationships will not typically give rise to concern, participation in a common but unrelated business venture from which the director derives a significant financial benefit could be sufficient to call into question the director's ability to make an independent decision.

8. What action should be taken if a committee member later becomes conflicted?

Ideally, the board will have anticipated potential conflicts at the outset of the committee process. For example, where a board is considering a potential change of control transaction, the board should also consider whether any prospective committee members are associated with potential suitors. In those cases, even where it appears unlikely that the potential suitor will be interested in a transaction, the board should consider excluding the relevant director from committee consideration as it is possible that circumstances could change.

Where a conflict does arise, the committee itself should first consider the nature of the conflict as balanced against the benefits to be gained from his or her continued role on the committee. In many cases, it may be appropriate for the committee member to promptly resign from the committee so that the process is not compromised.

Committee members should also keep other committee members and the board apprised of any change in their circumstances that could give rise to questions about their independence.

9. How should members of a special committee be compensated?

a) Compensation Structure

Compensating committee members for their time and effort in fulfilling the committee's mandate is customary and appropriate. By its very nature, the volume of work undertaken by a special committee is not always easily forseen or priced into the directors' general board compensation. In many cases the special committee members will be required to spend significant time and effort in order to fulfil the committee's mandate and to ensure that they have properly discharged their duties.

Compensation arrangements generally involve one or more of the following and are typically paid in cash:

- a flat retainer fee (which in some cases may be expressed as a monthly or quarterly fee), often with the committee chair receiving a greater amount to account for the additional responsibilities of the chair;
- a per meeting fee, which may be lower where attendance is by phone given that there is less disruption or travel time involved in attending the meeting (often the quantum is based on the attendance fee paid to the directors for attendance at regular board or other committee meetings); and
- reimbursement of reasonable expenses incurred by committee members in connection with the discharge of their duties, often consistent with the board's existing expense reimbursement policy.

A per meeting fee is one compensation method to address the potential problem of gauging the extent of the committee's work at the outset of a committee process. Where the work of the committee turns out to be more intensive than originally anticipated, the per meeting fee can serve to balance a retainer fee that in hindsight could be viewed as providing insufficient compensation.

To avoid later disputes and to avoid the appearance of any impropriety, compensation arrangements should be established at the commencement of the special committee's activities. In transactions governed by the Special Transaction Rules, the securities regulators in Ontario and Quebec are of

the view that compensation of committee members ideally should be set when the committee is created and not success based.

If the compensation structure is not appropriately designed at the outset, it may be difficult to compensate committee members after the fact without raising questions concerning their independence. For example, on successful completion of an M&A transaction, if committee members are compensated with a "bonus" or other payment in recognition of their efforts, outside observers may question whether such payment was linked in some manner to the outcome of the transaction on which the committee was advising (such as a "success fee") and therefore could have influenced the committee's deliberations. In that regard, a member of an independent committee is generally prohibited from receiving any payment or other benefit that is contingent on the completion of a transaction to which the Special Transaction Rules apply.

b) Amount of Compensation

A question on which directors often seek guidance is the appropriate amount of compensation that should be paid to committee members. There are no specific rules governing the quantum of compensation in these circumstances, though some guiding principles may be helpful:

- The board should consider the organization's general board compensation philosophy and practices.
- The quantum of compensation should not be excessive in relation to the fees paid to board members in connection with their regular board duties or, for that matter, the compensation paid to management.
- As a further reference point, the board also may look to the compensation paid to members of the audit committee, a committee whose independence is legislatively mandated.

In establishing the compensation structure and quantum of compensation, public company directors should bear in mind that the committee fees ultimately will need to be disclosed to shareholders in a management proxy circular where disclosure of the compensation paid to the company's directors is required.

Gathering public information regarding committee fees is difficult due to a variety of factors, including the fact that special committee compensation in the context of a change of control transaction may not be reported if the subject company is taken private prior to the company's next annual meeting (when such fees would have to be disclosed). Based on an informal, "unscientific" survey of available public disclosure in management information circulars and similar public filings in recent years, it is evident that compensation practices are varied, though many compensation arrangements contain the key elements described above.

Providing firm guidance on committee compensation structures is challenging as compensation

arrangements are often driven by the circumstances of the particular transaction in which the committee is involved, including the size of the company and its general board compensation practices and the substance and scope of the committee's mandate. For example, a fixed fee of under $10,000 might initially seem insignificant compared to the fees paid in other cases; however, such a fee may be entirely appropriate if, for example, the committee's work is completed in a very short time or if fees are also paid for attendance at meetings. Based on a review of public filings and anecdotal evidence, typical compensation paid to members of a special committee of a larger TSX-listed company involved in an M&A mandate ranges from approximately $25,000 to $50,000 or more for regular members, with an additional amount paid to the committee chair (in the range of $10,000 to $25,000 or more), plus a fee paid for attendance at committee meetings.

10. Will the establishment of a special committee or its activities require public disclosure?

While the mere fact that a special committee has been established will generally not require public disclosure, the circumstances leading to the creation of the special committee may make it desirable to disclose the existence of the committee, especially where the circumstances are already publicly rumoured or known, or otherwise require disclosure. For example, a company targeted by an unsolicited take-over bid often discloses that a committee has been established so that shareholders are assured that a considered response is underway. In other circumstances, the board may disclose that it has established a special committee to review strategic alternatives or to conduct a public auction. In those circumstances, the company may disclose the committee's existence as part of a larger strategy designed to put the company "in play".

A committee must also recognize that, whether its existence is publicly known at the time of formation, its review and decision-making process may need to be disclosed in detail at a later stage:

- In the public M&A context, applicable securities laws typically require detailed disclosure concerning the deliberations of the board and the special committee, including a discussion of any materially contrary view or abstention by a director and any material disagreement between the board and the special committee.
- In other circumstances, it is possible that a court or regulatory body will fashion a disclosure-based remedy where a board decision is challenged. In those circumstances, it is possible that items such as reports and other materials reviewed and considered by committee members will need to be disclosed.
- In some cases a board may be required to address a particularly sensitive matter which is appropriate to delegate to a special committee, but which the board may wish to maintain in confidence until a decision has been made. For example, a board may wish to have a special committee investigate potential allegations of wrongdoing to determine their legitimacy prior to any public disclosure. In these cases, the board and committee need to be particularly mindful of the ways in which the existence of the committee, and therefore the subject of its review, could be disclosed prematurely.
- As noted earlier, a public company's regular annual filings may require the disclosure of the committee or, at a minimum, the fees paid to directors, including any committee retainer fees. In some cases where disclosure considerations are particularly sensitive, the board may wish to consider deferring the earning and payment of fees until after this annual disclosure has been made in order to justifiably preserve the confidentiality of the committee's process, having regard to the best interests of the corporation. Another alternative is to delegate the decision-making authority, at least initially, to an existing standing committee, such as the audit committee or a governance committee, provided that the committee members have the appropriate independence to carry out the mandate.

As it conducts its review process, the committee and its advisors must be mindful of the potential disclosure record that may need to be produced at a later stage, including by maintaining an inventory of committee materials and keeping reasonably contemporaneous minutes of all formal committee meetings.

Part III – Duties and Liabilities

11. What principles should guide the committee in the discharge of its mandate?

In discharging its mandate, special committee members should be guided by the principles and expectations implied by the business judgment rule. In general terms, a special committee will need to exercise independent judgment, ensure that it exercises an appropriate level of diligence in the time allotted for its review, and identify, consider and manage the reasonable expectations of all affected stakeholders. What follows below are some practical steps that can and generally should be taken by a special committee in discharging its mandate.

a) Independence and Integrity of Process

A special committee will be expected to carry out its mandate independently and exercise independent judgment, particularly in circumstances where a committee has been established to address real or perceived conflict of interest concerns.

- *Ensure independence of committee members*: Each member of the special committee should consider the matter under review on its merits, uninhibited by competing outside considerations. As noted earlier, the board should consider the various relationships and interests of the committee members and consider whether those relationships give rise to any conflicts, real or perceived. Committee members themselves should be alert to potential conflicts that may arise at a later stage in the committee's process and address them promptly.
- *Ensure the committee has control over its process*: The special committee's mandate should generally provide that it has control over its process, including its meeting protocol, how and when it engages with management and others within the organization, and how and when it engages outside advisors. While the committee often will need to consult with management and others within the organization who are not committee members for information gathering purposes, the committee should ensure that its deliberations are carried out independently during *in camera* meetings with its independent advisors.
- *Solicit independent advice from outside experts*: The special committee should be empowered to retain its own advisors at the expense of the corporation. Directors are entitled generally to rely on the advice and opinion of professional advisers and other experts, including investment bankers, lawyers and accountants, provided that they have done so acting reasonably and in good faith. In a special committee process, the committee should ensure that its advisors are able to provide impartial advice which will be of assistance in demonstrating that the committee's reliance on the advice was reasonable. These advisors assist the committee in understanding the legal, business and financial implications of the matters being considered and have an appropriate understanding of the regulatory and financial framework that should guide their decision-making.
- *Document deliberations carefully and contemporaneously*: The committee should ensure that a reasonably contemporaneous record of the committee's proceedings is prepared, preferably by a party who is in attendance for all portions of the committee's deliberations, including any *in camera* session. In some cases, the secretary may be a member of management, although outside counsel should be considered as an alternative. At a minimum, outside counsel should maintain a record of *in camera* proceedings. Minutes should then promptly be reviewed and approved by committee members. In conducting this review, committee members should ensure that the minutes reflect the matters discussed and the advice obtained so that it is clear that the special committee focused on the important issues and proceeded in a thorough and informed manner. Any records of the committee should generally be maintained in confidence at least until the committee has reported to the board and potentially longer depending on the circumstances.
- *Consider timely disclosure requirements*: The committee may need to cause the company to issue press releases in order to communicate with shareholders and other stakeholders in connection with material developments. In unusual circumstances, the committee may need to issue press releases itself.

Where a corporation has a controlling shareholder that is a counterparty to a proposed transaction, the task of the independent directors can be thankless. On the one hand, the need for the committee to act independently is of particular importance. A competing factor the directors may face is that, under corporate law, the controlling shareholder has the power to replace the board. Nevertheless, special committee members are expected to act independently with the interests of the other affected stakeholders, including minority shareholders, in mind. In that regard, a controlling shareholder in these circumstances should have a similar interest in ensuring a process that is, and is seen to be, independent as the transaction will be less susceptible to challenge, thereby increasing deal certainty.

b) Consideration of Stakeholder Interests

The stakeholder interests engaged will vary depending on the circumstances. In a change of control context, some obvious stakeholder groups to consider include shareholders and creditors as well as employees, suppliers and customers. Similar stakeholder groups may be engaged in other contexts as well; however, the expectations of those stakeholder groups may differ or carry differing weight. In the context of an allegation of wrongdoing, the principal interest at stake may be the long-term reputation of the corporation.

- *Identify affected stakeholders*: A special committee must be mindful that there are no overarching legal principles in Canada that dictate when a particular stakeholder interest takes precedence over another. Accordingly, the committee must appropriately identify and evaluate the stakeholders affected by its potential decision as well as the reasonable expectations of those stakeholders in the circumstances.
- *Factors to consider in determining reasonable expectations*: Committee members may receive some guidance from the following factors cited in various court decisions in determining whether or not a reasonable expectation exists:
  - general commercial practice;
  - the nature of the corporation, such as whether it is closely or widely held;
  - past practice, which may be subject to change over time in response to valid commercial reasons;
  - preventative steps the stakeholders might have taken to protect themselves against a potential board decision;
  - representations and agreements, such as statements in offering documents, press releases, analysts' calls, promotional material or other public communications.
- *Monitor stakeholder reactions*: In reviewing the fairness and reasonableness of the matter under consideration, the special committee should be kept advised of any complaints or other commentary from potentially affected stakeholders. In doing so, the committee will have a better understanding of the current thinking of stakeholder groups.
- *Resolve stakeholder interests in a fair and balanced way*: Once the stakeholder interests are identified, the committee will need to determine how the interests of those stakeholders may be impacted by the decision. The committee will be expected to resolve any conflict among stakeholders or stakeholder groups in a fair and balanced way. In circumstances where a change of control is inevitable (often referred to as the corporation being "in play"), a committee may well determine that the most prudent course of action is to ensure a fair and efficient auction is conducted. In other circumstances, such as where a controlling shareholder has determined to sell its interest to a particular purchaser, Canadian courts have determined that an auction may not be appropriate based in part on the fact that the board has a more limited role in selecting a purchaser; however, in those circumstances, the board should attempt to ensure the most favourable transaction for minority shareholders in the circumstances. In that regard, Canadian courts have recognized that there is no single "blueprint" that directors must follow.

c) Ensure Adequate Investigation and Review of Information

To properly evaluate any decision, a committee must ensure that it has a proper understanding of the issues before it, including an understanding of all relevant facts and the risks involved in any proposed course of action.

- *Gather and analyze sufficient information*: The special committee should ensure that it has a proper understanding of the legal, business and

financial implications of any particular matter under consideration. In doing so, the committee members should not accept advice or information without question, and should make appropriate inquiries.

- *Communicate with management and the board as appropriate*: Management can be a valuable resource to the committee given management's intimate knowledge of the day-to-day affairs of the business. In the context of an M&A mandate, it may be appropriate for members of management to be involved in negotiations with potential bidders on behalf of, and subject to the direction of, the special committee or to act as intermediaries between the special committee and potential bidders. Any interaction with management should, however, be subject to consideration of any conflict in the interests of management with those that the committee is to serve.
- *Take sufficient time*: A special committee must not make decisions with undue haste. Whenever possible it is desirable for committee members to meet in person, particularly where significant decisions are to be made. It may be more appropriate for a committee to delay a process for a period of time to allow it to make appropriate inquiries to ensure a complete understanding of the matters under consideration. The committee should ensure that relevant materials are delivered prior to any meeting at which a decision is made and appropriate time is allotted for any expert presentations and proper discussion at the meeting.

d) Decision Within a Range of Reasonable Alternatives

The business judgment rule provides, among other things, that a board's decision must be within a range of reasonable alternatives in order to gain deference from the courts. Provided that a special committee has undertaken a process with appropriate rigour and has been guided by independent advisors, it should have a clear understanding of the reasonable alternatives with respect to the decision it has been asked to make.

Ideally, the alternatives considered and the material reasons in favour of and against each such alternative will be documented. In that regard, the ultimate disclosure and rationale for the decision made, whether it is to the board, shareholders or a court can be as important as the decision itself.

- *Documentation of alternatives considered*: Throughout its process, the committee will be faced with many potential decisions, including many that may be ancillary to the principal decision at hand, such as decisions concerning disclosure, engaging advisors, and committee protocols. In each case, the committee should have a clear understanding of the reasons in favour of any course of action and how its decisions may impact its ultimate recommendations. When deliberating over its recommendations, the committee should ensure that it receives appropriate advice as to the alternatives available, the risks and uncertainties in selecting any potential alternative as well as the factors that may favour one alternative over another. The committee should not be seen to have unduly disregarded or foreclosed pursuing potential reasonable alternatives.
- *Ensure the adequacy of disclosure in applicable disclosure documents*: The committee should ensure that it undertakes a careful review of applicable disclosure documents (including press releases, material change reports and information circulars), which may require discussions with management, advisors and others in order to resolve any questions or uncertainties. While a board decision may be subject to significant scrutiny, any criticism will be blunted if the disclosure of the board's decision-making process is clear, comprehensive and balanced. The disclosure should typically include the process by which the committee was established, a summary of its terms of reference, key milestones in the committee's review process, a description of the expert advice sought and the reasons why a particular course of action was selected.

12. When should a committee engage outside experts?

To ensure the deference afforded by the business judgment rule, a special committee should properly understand the various legal, financial, accounting and other issues that may arise in the course of the committee's mandate and make appropriate inquiries where these issues are not fully understood. A common method of obtaining such understanding is for the special committee to engage expert advisors.

a) Engaging Experts

The committee's mandate should empower it to determine when and whom to select as an independent expert advisor and set the terms of engagement. As part of negotiating the engagement letter, the committee should also clearly set out the expert's compensation, which should be paid for by the company. The committee's deliberations concerning the engagement of its expert advisors should also be properly documented.

When retaining an outside expert, the special committee should seek an expert that can provide impartial advice and guidance. The committee should directly negotiate the terms of engagement, ensuring that its engagement is proper in scope. Generally speaking, an outside expert should be charged with undertaking specific tasks, with appropriate standards of care, deadlines and reporting protocols, to ensure that the committee receives advice that is thoughtful, professional and comprehensive. Throughout its review process, the committee should also periodically evaluate the performance of the expert advisor, including whether it is adhering to the terms of its engagement.

As outside experts necessarily increase the costs to the organization, the committee should consider the appropriate time at which such experts are engaged. It is typically an easy decision for a committee member to conclude that an outside expert is needed as often the only downside is the added cost to the company; however, for that reason, the committee may wish to consider delaying an advisory engagement where it is uncertain that the expert will be needed.

b) Role of Experts

In some circumstances, the expert's role will be quite specific and its involvement substantial. For example, in an insider bid, the committee will generally be required to retain an independent financial advisor to prepare a formal valuation. In those circumstances, the committee also will retain independent legal counsel who may act as primary legal counsel on the transaction from the perspective of the target, will negotiate the terms of the target company's support, if such support is warranted, and will prepare the requisite disclosure documents.

In the context of an internal investigation, the committee may retain forensic accountants or other investigative experts to review company records and may retain legal counsel to direct the investigation and to provide advice in connection with any interaction with regulators or public disclosure obligations arising from the investigation.

In other circumstances, the advisor may provide more general oversight and will advise the committee on issues only as conflicts arise. For example, in the context of a company-initiated auction of a public company, a special committee may retain its own legal counsel to provide advice in tandem with the company's legal counsel and to provide both a second opinion on certain matters and to advise on matters where the company's legal counsel may be conflicted. In other circumstances, the committee may rely generally on the advice of the financial advisor retained by the board of directors in connection with a transaction; however, the committee may at a later stage in the process retain its own financial advisor to provide a fairness opinion.

The question often arises in circumstances where a company has engaged a financial advisor to conduct an auction process who will receive a success fee for its services. Depending on a variety of factors, including the nature of the auction and the advisor's compensation structure, the committee may choose to engage its own financial advisor on a flat fee basis at a later stage to provide an independent fairness opinion concerning a transaction; however, the committee may defer any such engagement until it appears likely that a transaction will proceed. A competing concern will be that the expert is engaged in sufficient time so that the advice given to the committee will be preceded by a thorough review and analysis by the expert.

In other circumstances, at least at the initial stages of its engagement, a special committee may choose to rely on the advice of the company's existing legal counsel given counsel's familiarity with the business and affairs of the company. A committee should so proceed with caution as the company's counsel also takes instructions from and engages with management and the other board members who may be conflicted. Should a committee choose to rely on the company's counsel for advice, the committee should periodically

reassess whether independent counsel may be needed at a later stage in the process.

In making any decision concerning whether to engage independent experts, committee members should consider that courts often look to the independence of the advice that was received by the committee in evaluating the process by which a decision was reached.

c) Reliance on Experts

While formal legal and financial advice is often a necessity, the committee's reliance on the advice must be reasonable. The committee should ensure that the advice is not accepted without question. Committee members should question the committee's advisors where appropriate and minutes of the meetings of the committee should reflect both the fact that the members have done so and the nature of the responses received.

13. What factors should be considered when selecting and engaging outside experts?

Directors are entitled generally to rely on the advice and opinion of professional advisers and other experts, including investment bankers, lawyers and accountants, provided that they have done so acting reasonably and in good faith after exercising appropriate judgment. As a result, a special committee should take steps to ensure that its advisors are properly motivated, experienced and provide impartial and thoughtful advice.

a) Impartiality of Advice

When retaining advisors, the committee should consider the potential advisor's past, current and reasonably foreseeable relationships with the other parties involved in the transaction to ensure that the advice received is independent. While it may be appropriate for the committee to inquire from management and others in the organization as to potential candidates, committee members should not necessarily confine their choices to those candidates. Committee members should also consider their own contacts and those of the committee's other independent advisors.

The committee should ask any prospective advisor to disclose, subject to any applicable rules of conduct, any such relationships. For example,

when selecting a financial advisor, the committee should consider whether the advisor has provided advice or other financial services to any of the parties to the transaction with an interest adverse to those that the committee represents. Committee members should review the potential conflicts of all advisors in much the same way as potential conflicts of the members themselves are to be reviewed by the board.

In the public M&A context where a company is conducting a market canvass or auction process, the company's financial advisor may wish to offer debt financing (also referred to as "stapled" financing) to prospective purchasers. This arrangement is not uncommon where the advisor is part of a larger group that offers institutional lending. The arrangement has its advantages given that it may enable more potential purchasers to submit offers given that financing is made available from a source already familiar with the company; however, the arrangement could lead to a questioning of the financial advisor's independence. Among other things, the financial advisor generally stands to receive significant lending fees, which may exceed by a significant margin the financial advisory fees payable by the company in the event that a prospective purchaser completes a transaction using the credit advanced by the financial advisor. In

these circumstances, the special committee should consider whether to allow the financial advisor to offer stapled financing at all. If the committee does allow the financial advisor to offer such financing, the committee should ensure that the financial advisor provides sufficient comfort that the independence of its advice to the committee will not be compromised and may consider engaging a second advisor. In particular, the committee should consider engaging a separate financial advisor on a flat fee basis, with no success fee, who can provide a second opinion to the board. In light of judicial developments concerning advisor conflicts, a committee is well-advised to ensure that shareholders have a proper understanding of the compensation arrangements of the committee's advisors, including any success fee element.

In the context of an insider bid, the Special Transaction Rules prescribe certain relationships that preclude a financial advisor from being considered independent, in which case that advisor would be unable to prepare the formal valuation necessary in such a transaction. While the Special Transaction Rules impose these independence requirements on a financial advisor only when the advisor is to prepare a formal valuation, the relationships prescribed may be considered as indicative of the types of relationships that should be considered in all cases. In any retainer agreement with a financial advisor, regardless of whether or not the advisor is being retained to prepare a formal valuation, the committee should seek an express representation from the advisor concerning its independence.

When retaining legal counsel, the committee should consider whether counsel has any ongoing or prior relationship with any of the parties involved in the matter for which the committee has been established. Applicable rules of conduct governing the legal profession may prevent the company's legal counsel from acting for the committee in those circumstances; however, even where a legal conflict does not arise, it is often prudent for a special committee to retain its own legal counsel to advise it separately from the company's legal counsel. This is particularly important where management may be conflicted since members of management often will be the individuals instructing the company's legal counsel on a day-to-day basis.

b) Experience and Reputation

When engaging an expert advisor, the committee should review the qualifications of the advisor to perform the task for which the advisor is to be retained. Canadian courts may assess the experience and reputation of the committee's advisors in evaluating whether a committee's reliance on those advisors was appropriate.

The committee may wish to examine, among other things, the prospective advisor's experience in similar matters and the resources available to the advisor. Other factors to consider include industry reputation, relevant expertise, geographic location and, where an organization is being engaged to provide advice, the experience and reputation of the particular individuals in the organization proposed to provide the advice. Ultimately, the advisor must be properly suited to the matter under review. While a larger advisory firm may be appropriate for some engagements, a smaller boutique firm or a particular individual with a special expertise may be more appropriate in other circumstances.

To the extent that time permits, it is prudent to consider, and request proposals from, more than one potential advisor prior to the selection of an advisor. Depending on the confidentiality of the committee's mandate, the committee should bear in mind that, in making a request for proposals, confidentiality could be compromised depending on certain factors, including the number of advisors solicited and the size of the industry in which the advisor operates. To address this concern, the committee may wish to rank its prospective advisors and then interview its first choice prior to contacting any other candidates. If that candidate proves acceptable, then no further interviews need to be conducted.

c) Compensation

When establishing the compensation to be paid to a special committee's advisors, the committee should take care to ensure that the impartiality of the advice to be provided by the advisor is not compromised. Generally, the payment of customary professional fees to legal counsel, accountants or other professional advisors will not give rise to such concerns. The issue arises in connection with the compensation of financial advisors given that the compensation structure for these advisors often

includes some compensation contingent on the success of the transaction.

Where an advisor is compensated based in some measure on the successful completion of a transaction, the impartiality of the advisor could be called into question; however, in financial advisory engagements, some element of a success fee is quite common. In assessing any such arrangement, the committee must balance the risk that the advisor's impartiality may become compromised against the need to appropriately motivate the financial advisor to maximise value in the transaction. In making its assessment, the committee also should consider whether the financial advisor would receive fees from any other source in connection with the transaction, such as in the case of stapled financing discussed above. The committee also must consider that if a success fee were to be eliminated altogether (other than in cases where a success fee is prohibited, such as where the advisor is to prepare a formal valuation for purposes of the Special Transaction Rules), it is quite possible that the financial advisor would seek a higher retainer or work fee, in which case the committee could be criticized for incurring potentially significant expenses even where no transaction is undertaken. As noted earlier, where the company's principal financial advisor is compensated on a success fee basis or is offering stapled financing, the committee should also consider engaging a second financial advisor on a flat fee basis, without a success fee component, to provide a second opinion to the committee.

In all circumstances, it is critical that the question of an advisor's compensation, and any special arrangements with respect to such compensation, be established at the outset and properly documented.

14. Are communications between committee members and its experts protected against disclosure to third parties?

A key element of ensuring the independence of a special committee process is to maintain confidentiality over its deliberations and, to the extent possible, other communications. In any communication, committee members should consider carefully the rules that govern the disclosure of its internal communications and communications with its expert advisors. Understanding the rules can assist in ensuring that certain communications are not disclosed prematurely or out of context, which could lead to a questioning of the committee's process.

a) Privilege of Communications with Legal Counsel

Under Canadian law, the right to privileged communication with legal counsel is well-protected. Confidential communications between legal counsel and a client for the purpose of providing legal advice or legal services are protected by solicitor-client privilege. Privileged communications are not producible in legal proceedings and cannot be used as evidence against the client unless the client has waived the privilege or the communication is otherwise no longer confidential. The protections against disclosure afforded by solicitor-client privilege allows the client to exchange communications with its legal counsel in a frank, and potentially embarrassing, manner, to enable the uninhibited exploration of issues and informed legal advice.

Evaluating the scope of legal privilege to communications between a special committee and its counsel depends in part on who is considered the client from a legal perspective. A special committee does not constitute a separate legal entity – members of a special committee act as board members and as agents of the corporation with fiduciary duties to the corporation. Confidential communications between legal counsel and committee members (in their capacity as committee members) would in the normal course be subject to solicitor-client privilege, with the corporation as the client. As a result, the right to waive privilege rests with the corporation, acting through the board, and not the committee. Members of the committee would presumably be obligated to maintain privilege and confidentiality of such communications, except where a waiver of privilege has been authorized by the full board, either expressly or implicitly.

A question also arises as to whether individuals within the organization who are not committee members may know the content of the committee's privileged communications. While not free from doubt, a strong argument can be made that other board members or officers, particularly those having a conflict of interest, should not have a right to obtain or know the content of privileged communications during the committee's mandate and, depending on the circumstances, perhaps even after the conclusion of the mandate. The independence of the committee's process could be

undermined if legal advice received by committee members could be disclosed to other directors or officers during the mandate of the committee. Although there is no Canadian jurisprudence on point, disclosure within the corporation would presumably be a matter within the business judgment of the special committee.

In legal proceedings brought by a third party against a corporation, privileged communications with counsel to the full board should not be producible. Even if the committee were considered a distinct legal entity for purposes of the law of privilege, disclosure of privileged communications to the board in circumstances where the committee maintained confidentiality over its process would likely give rise to what is referred to as a "common interest" privilege, protecting the communications from production to third parties.

In circumstances where a director or officer of the corporation brings legal proceedings against the committee members and the corporation, potentially as a result of dissatisfaction with the outcome of the committee process, the litigant would be considered a third party and the communications between the committee and its counsel would remain privileged. In these circumstances, the litigant is suing in an individual capacity and not as a representative of the corporation.

b) Communications with Other Experts

Confidential communications between a special committee and its expert advisors other than legal counsel are not generally protected by privilege. As a general practice, it is prudent to exclude such experts from discussions among committee members and legal counsel where counsel is providing advice or committee members are providing information to legal counsel for the purposes of counsel providing legal advice.

While there is limited jurisprudence on the subject, some notable court decisions have upheld an assertion of privilege over solicitor-client communications that also included other non-lawyer experts in limited circumstances. In general terms, the exception applies where the services of an expert are required to assist the lawyer to understand the information being provided so that competent legal advice can be provided. To assert privilege in these circumstances requires, at a minimum:

- evidence of the strict maintenance of confidentiality between the committee, legal counsel and any non-lawyer expert involved in the communication;
- clear linkage between the advice given by the non-lawyer expert and its necessity for the legal services provided; and
- involvement of the non-lawyer expert in communications only to the extent necessary to ensure competent legal advice in the circumstances.

In one case articulating this exception, the court found that communication with an expert would be privileged if the expert was, in effect, providing translation services for the benefit of the lawyer to enable the lawyer to provide competent legal advice. Information assembled by the expert for this purpose would presumptively be privileged. However, where the corporation or the committee required the information for another purpose, such as to make a business decision distinct from the legal advice, then the information assembled and communication by the expert would presumptively not be privileged. In other words, non-privileged information from an expert required for some purpose other than providing legal advice cannot be cloaked with privilege by seeking legal advice using the same information.

In another case, a litigant sought production of all deal team communications that involved the corporation's external advisors, which included lawyers, investment bankers, and technical consultants. The court upheld the general rule that there was no general "deal team" blanket privilege; however, after reviewing the facts before it, the court found that each of the non-lawyer experts was appropriately considered part of the "team" for the purposes of requesting, obtaining or receiving legal advice. The court noted that there were a relatively small number of non-lawyers involved from outside the corporation whose input was "necessary and appropriate to the consideration, structuring, planning and implementation of very complex transactions in a very short time." The fact that the individuals understood they were bound by confidentiality was of assistance in the court's finding but was not sufficient to constitute privilege. The court held that, having reviewed all of the documents, it understood "the need for and receipt

of specific advice and knowledge necessary for the overall legal considerations of the transactions." The court also observed that disclosure within the organizations providing outside advice was limited to the very individuals whose input was needed.

Communications with experts might also be protected by what is referred to as "litigation privilege". This privilege protects information assembled or communicated for the purposes of conducting litigation or closely anticipated litigation. Litigation privilege is potentially broader in scope than solicitor-client privilege, but the privilege expires with the lawsuit and is only applicable as against the other parties to the lawsuit. The work of a damages expert for a litigation committee, for example, would be protected by litigation privilege. However, if the corporation subsequently used an expert's report as evidence on the matter, then the litigation privilege over the communications with and other related work product of the expert will have been waived.

Another potentially relevant privilege could be privilege in respect of communications made for the purpose of attempting settlement of a disputed matter. A concession communicated to another party in an attempt to achieve a settlement would be privileged against being used as evidence against the maker of the concession in subsequent legal proceedings. Where a committee is involved in settlement discussions and communicates with experts and disclosure of such communications would reveal the concession made in a settlement offer, the settlement privilege would presumably extend to such communications.

c) Communications among Committee Members

Confidential communications among committee members are not generally protected by privilege. Again, the question of whether individuals within the organization who are not committee members are entitled, in their capacity as representatives of the organization, to know the information is a distinct question for corporate law concerning the ambit of confidentiality. There are strong arguments that such communications should remain confidential during the mandate and presumably disclosure within the corporation would be a matter for the committee to decide in its business judgment.

There are limited types of communications among committee members that would be subject to privilege. Specifically, a confidential communication among committee members of a privileged communication received from a lawyer would remain privileged, as would a communication among committee members to be re-conveyed to legal counsel for the purposes of obtaining legal advice. In these situations, the committee members are essentially acting as conduits of information to or from legal counsel or other non-lawyer experts where solicitor-client privilege may extend to such communications, as discussed above.

Legal considerations aside, committee members should use caution in their written correspondence, including in e-mail and other electronic communications which can be unsecure and are often treated as more informal communications tools. As a practical matter, committee members should carefully consider the content of any such correspondence, recognizing that it may be produced in legal proceedings, potentially without any of the surrounding context and with adverse, or at least embarrassing, results. In some cases, it may be appropriate to send communications through or at least copy the committee's legal counsel in an effort to preserve privilege.

15. What steps can committee members take to protect against personal financial exposure?

It is perhaps not surprising advice that the best way for a committee member to protect against personal financial exposure is to ensure that his or her duties are properly discharged. It is also recognised that special committees are often created in response to circumstances that are or may become contentious or even litigious. Even in circumstances where the committee member acts appropriately in discharging his or her duty, the possibility remains that he or she may be subject to legal or regulatory proceedings which can be both costly and time consuming, even if the director subject to those proceedings ultimately is vindicated. While potential legal exposure to such proceedings is an ongoing risk for directors, committee members can take some action to mitigate the risk of financial loss in the event that they become subject to those proceedings, though these actions are not unique to directors serving on a special committee.

a) D&O Insurance

At the outset of any mandate, committee members should provide for a review of the company's directors' and officers' insurance policy to ensure that it will cover the circumstances under review by the committee. For example, some directors' and officers' insurance policies may exclude or limit coverage in connection with non-arm's length transactions. Accordingly, directors may wish to determine whether additional coverage should be obtained in circumstances where a transaction involves a related party such as the company's controlling shareholder.

In the context of a transaction where a change of control may occur, directors should also ensure that appropriate run-off coverage (also referred to as a "tail" policy) is in place to protect against claims the directors may face based on matters arising prior to the change of control transaction. Directors can do so either through the company purchasing it directly or by ensuring that the purchaser of the business is obligated to do so. The directors in this situation should also take steps to ensure that the acquirer will not undertake activities to restrict or weaken the legal or practical effect of existing indemnification arrangements in favour of the directors. The trustees of a business trust may also wish to seek appropriate protections given that they may no longer have recourse to the trust assets to satisfy an indemnity claim depending on how the transaction is structured.

b) Indemnities

At the outset of the committee process, it is also prudent for directors to re-examine any indemnity in their favour in the company's by-laws or by way of contract. Where an indemnification contract has not been entered into with the corporation, committee members would be well-advised to do so at the outset of the committee's mandate. Where the director serves on a board of a company that is a subsidiary of another company, the director may wish to seek an indemnity from the parent company as well. In addition, the indemnification of the committee members may be included as a specific item in the committee's mandate.

Part IV – Process and Deliberations

16. How can the committee ensure the independence of its process?

As noted earlier, a board is likely to be protected by the business judgment rule provided that its decision is preceded by a rigorous and independent special committee process. While there are many prevailing governance practices designed to ensure an independent special committee process, many of them can cause friction within an organization given the need for confidentiality and independence in deliberations. Accordingly, a special committee will need to design a process that conforms to applicable legal standards while at the same time managing the practical issues that may arise within the organization.

a) Control Over Meeting and Reporting Process

As a general rule, a committee's independence is enhanced where it is given greater control over the manner in which it discharges its mandate, including by establishing its own protocols and procedures, selecting its advisors and determining how it will engage with others within the organization.

The mandate of the special committee should address the procedures that will govern the committee's formal meetings and deliberations and may set out the notice requirements for meetings, quorum requirements and related matters. In some cases, the committee's meeting protocol is specified with reference to the procedures specified in the company's by-laws governing board meetings. In other circumstances, the committee is empowered to establish its own procedures which is the approach that provides for the most independence. Depending on the matter under review by the committee, the committee may wish to establish more stringent quorum requirements than are called for by the company's by-laws or, in other circumstances, the committee may wish to require matters to be approved by more than a simple majority vote. The committee may wish to grant the chair a second or casting vote, such as where the committee is comprised of an even number of members. In all cases, the committee will have to exercise appropriate business judgment to ensure that its

protocols and procedures establish a framework for a reasonable decision-making process.

b) Committee Chair

A special committee should be prepared to meet often and in many cases those meetings may be called on short notice. It is generally preferable for the committee to meet in person and with their advisors present in person. The dynamic of an in-person meeting is generally preferable to a conference call meeting with individuals potentially in multiple time zones or dealing with multiple distractions. While the geographic dispersal of many boards coupled with busy travel schedules often dictate that not all meetings can be conducted in person, committee members should make efforts to attend meetings in person where significant decisions are to be made or significant issues are to be debated or expert advisor presentations are made.

While the committee will often require input from the board, management and others within the organization, the committee must ensure that it meets alone with its advisors regularly and at least as part of every formal meeting. The committee's meeting process may be further enhanced by periodic informal meetings and discussions between the committee chair and legal counsel and by the chair and other members of the committee. Doing so can assist in setting the agenda for meetings and ensuring that meetings are spent productively, including by ensuring that non-committee members are invited only on an as-needed basis.

In many cases, when establishing the special committee, the board of directors will appoint the chair. In other cases, the committee itself may be empowered to appoint the chair, which enhances the committee's independence. While the issue may be insignificant in many cases, the board may wish to empower the committee to appoint its own chair particularly in circumstances where the board determines it appropriate for the committee to operate with a greater degree of independence. The committee chair plays a central role in setting the tone for the committee's process and will often liaise with the committee's legal counsel in setting meeting agendas, anticipating legal and political issues and acting as a sounding board for other committee members. A strong committee chair also may need to address any internal dissent within the organization that may arise due to the confidentiality of the committee's process.

c) Control Over Engaging Outside Experts

As noted earlier, when selecting outside experts to advise a committee, committee members will often look to management as a first source of potential contacts. Those contacts may have significant industry knowledge and may be familiar with the organization. While seeking such contacts is customary, committee members should generally not limit their search to those contacts unless the committee is comfortable that those advisors can serve the committee's interests impartially. The committee should be mindful that management's contacts may have an interest in seeking further work from the organization in future or may have other friendships or business relationships that could lead to their independence being questioned. Accordingly, committee members should also consider their own contacts and those of the committee's other independent advisors. As a general rule, the committee may wish to interview more than one potential expert for a particular position, subject to any overriding concerns about confidentiality as discussed earlier.

d) Meeting *in camera*

As discussed above, a special committee may, and often should, involve non-committee directors and appropriate members of management in the course of fulfilling its mandate; however, at least a portion of the committee's meeting should be conducted *in camera* with only the committee and its advisors present. In that way, the committee can ensure that members are free to discuss issues of concern fully and openly without potentially conflicted parties present. Maintaining an *in camera* session as a routine portion of each meeting will also minimize the chance that those excluded may question the reason for the session. In some circumstances, the committee should also consider meeting entirely *in camera* where particularly sensitive issues need to be discussed and debated. Where a meeting is held by conference call, it is often good practice to conduct the *in camera* session using a separate dial-in number distributed only to the committee members and its advisors to ensure that there are no additional participants whether through inadvertence or otherwise.

e) Documentation of Deliberations — Minutes

The committee's meetings should be recorded in written minutes, which will serve as primary evidence in any inquiry into whether the committee members have properly discharged their duty. Committee members should review all draft minutes to ensure that they represent an accurate record of the discussions at the meeting. Any documents or reports delivered to the committee should also be appended to the minutes or otherwise retained to ensure that a complete record of the information considered and advice received by the committee is properly archived.

To ensure the most accurate record possible, it is preferable that the minutes be produced in a timely manner following each meeting of the committee and reviewed and approved shortly thereafter. Contemporaneous minutes may carry more weight than minutes prepared at a much later stage in the process, including after the commencement of legal proceedings.

Minutes should be sufficiently detailed to record the issues considered by the committee as well as the advice sought and received. Opinions differ on how much information should be contained in the minutes; however, the committee should ensure that an appropriate level of detail is recorded to demonstrate that the committee is entitled to rely on the business judgment rule with respect to the conduct of its inquiries and deliberations. Depending on the context in which the committee has been established, the committee may need to maintain the minutes in confidence and not disclose them to other board members or management or, potentially, the company's auditors, at least until such time as the committee's report is delivered to the board. In some cases, the secretary may be a member of management although outside counsel should be considered as an alternative. At a minimum, outside counsel should maintain a record of *in camera* proceedings.

In addition to documenting its process in minutes, the committee should generally document its recommendation in a written report to the board. The committee report should generally be prepared by the committee's outside legal counsel to preserve privilege, to the extent possible, and to ensure that the report addresses all of the various elements of the business judgment rule. While the committee may wish to consult with others inside the organization for purposes of factual verification of the committee report's contents, as a general rule the committee's report should be maintained in confidence at least until it is disclosed to the board.

17. What is the role of management and the board of directors in the committee's process?

While much has been said of the need for independence in a special committee process, the exercise of proper business judgment also generally dictates that committee members consult with the day-to-day operators of the business. Furthermore, it is generally appropriate for the board to receive periodic updates from the committee concerning its process so that the board can appropriately exercise its supervisory role.

a) Management

As a practical matter, the special committee will almost always rely on management to some extent, regardless of the committee's mandate, given management's expertise and day-to-day experience in running the company. In addition, management will be expected to assist the committee in carrying out its mandate by issuing press releases, drafting or commenting on disclosure materials and transaction agreements, establishing data rooms, or identifying consultants. Due to the need to rely on management, it is quite customary for the mandate of the special committee to direct management to co-operate with the committee.

Notwithstanding a special committee's reliance on management, the committee members also need to remain aware of the potential conflicts between the interests of management and the other interests that the committee must protect. In certain cases, management may be in a position of irreconcilable conflict and therefore should not unduly influence, or be seen to have unduly influenced, the committee's deliberations.

In the context of a special committee's review of strategic alternatives, management would be expected to have informed views regarding the business impact of certain initiatives and the viability of various alternatives. In those circumstances, it is appropriate to have members of management present during committee meetings

to provide information concerning the issues on which the committee is to deliberate. Often, senior management such as the Chief Executive Officer or the Chief Financial Officer can be an invaluable resource where the committee must consider, for example, the future prospects for the company and strategic options.

If, however, a strategic review includes or leads to an auction of the company the committee will need to carefully consider the potential conflicts that management may face. In particular, management may favour one prospective buyer over others, in spite of the relative merits of one proposal over another, if management perceives that it will have greater prospects for continued employment under one buyer than another. For example, management may favour a private equity buyer over a strategic buyer given that the strategic buyer may view current management as redundant. In other cases, management may be entitled to sizeable change of control payments that could influence their views on certain strategic alternatives. Consistent with the proper discharge of its duties, the special committee in this and similar contexts must ensure that it asks appropriate questions of management to probe the information that is presented by management.

In other contexts, such as an investigation into alleged accounting irregularities, the special committee would typically conduct its investigations and proceedings without management present, particularly those members of management whose activities are the very subject of the investigation.

Regardless of the level of interaction between the special committee and management, the special committee should, as a routine item of business, conduct some part of each meeting without management present. By making an *in camera* session a routine part of the committee's meetings, the committee may be able to avoid potentially uncomfortable circumstances in which management may grow suspicious of a sudden request for them to leave the meeting.

b) Board of Directors

The committee's duty generally is to report to the board and often to make a recommendation for consideration by the full board. In some circumstances, such as where an insider proposes to take the company private, the members of the committee also may be the only directors entitled to vote on the matter at the board level and, accordingly, the recommendation of the committee effectively becomes the vote of the board.

Prior to making its formal recommendation, the committee will generally provide regular updates to the board at meetings of the full board. In addition, the chair of the special committee may provide more informal updates on a periodic basis to the chair or other members of the board. This periodic reporting is designed to ensure that the board exercises appropriate oversight over the committee's process, given that they are delegates of the board.

Other board members may attend and participate in meetings of the committee out of interest or where a board member may have a particular expertise in a matter that is being discussed. While in many cases it is entirely appropriate for other board members to participate in committee proceedings, the committee should, as a routine item of business, conduct some part of each meeting without those other board members present. In that way, the committee can ensure that it uses available resources without compromising its independence.

18. How should the committee report to the board?

The manner in which the committee delivers its recommendation to the board will depend on the circumstances. In many cases, the committee will report to the board on an interim basis on the progress of its deliberations. Depending on the nature of the committee's mandate, the interim reporting by the committee may be very frequent or only on a periodic basis at regularly scheduled board meetings.

The committee's report should provide the board with a roadmap to the committee's ultimate recommendation, including by outlining the committee's mandate, the process followed by the committee in discharging the mandate, the advice sought and received, alternatives considered, the committee's recommendation, the reasons for the recommendation as well as the risks and uncertainties considered by the committee if the recommendation is acted upon. In some cases, the committee may deliver to the board a formal written recommendation while in other circumstances the report may be delivered orally and reflected in the minutes

of the meeting. The committee's report and minutes are critical, as they will serve as the primary record of the committee's actions and deliberations in any subsequent legal or regulatory proceeding.

19. Are the committee's reports and conclusions protected against disclosure to third parties?

In certain circumstances where the process and advice of the committee is undertaken in relation to a sensitive matter such as an internal investigation, care should be taken to ensure that the committee does not waive any solicitor-client privilege that may apply.

If the mandate of the committee is to obtain legal advice for the corporation, then the entire report should remain privileged against third parties when disclosed to the rest of the board in confidence. If the mandate of the committee is broader than simply obtaining legal advice and the report contains material not otherwise subject to solicitor-client privilege, then it would be prudent to report any legal advice in a separate report, or appendix that could be easily redacted should the report need to be produced in subsequent legal proceedings. The part of the report distinct from legal advice would not be protected by solicitor-client privilege.

The disclosure of the report to the board should be carried out in strict confidence to the members of the board in their capacities as directors and for no other purpose. The full board, on behalf of the corporation, would have the power to decide whether to keep the report confidential, or to waive any privilege and use the privileged portions for the purposes of assisting the corporation in any legal proceedings.

Where the committee mandate involves sensitive internal matters, the committee should consider isolating legal advice it received from its report to the board. The board, in its business judgment, may decide that disclosure to the full board would be in the best interests of the corporation. Such disclosure, however, would not waive the privilege as against third parties, including legal proceedings brought by affected directors or officers in their individual capacity, as opposed to using the information to fulfil duties as a corporate director or officer. On occasion, an entire report may be delivered by counsel in an effort to preserve privilege.

20. What is the board's role in reviewing the reports and conclusions of the committee?

Canadian courts have ruled that, in the M&A context, if a board of directors has acted on the advice of a committee of persons having no conflict of interest, and that committee has acted independently, in good faith, and made an informed recommendation as to the best available transaction for the shareholders in the circumstances, the business judgment rule applies. This reasoning could apply equally in other contexts provided that the committee has been properly established and has appropriately discharged its mandate.

In much the same way as the committee must make its decision on an informed basis, the full board should also carefully scrutinize the committee's report and ensure that the report and its conclusions are appropriately reviewed. The board may wish to review the recommendation with its own legal, financial and other advisors. Depending on the nature of the recommendations proposed, the board may wish to adjourn to consider the recommendations in detail. The board also will need to consider whether public disclosure of the committee's report or its conclusions is necessary.

In certain contexts, such as in a going private transaction by a controlling shareholder, the recommendation of the committee may not be one that the board responds to favourably, depending on the committee's conclusion and the composition of the board. In those circumstances, the committee members may be subject to detailed questioning regarding their conclusions. In other circumstances, the report of the committee may serve as the basis for further negotiations with respect to the transaction.

If a committee has conducted significant investigations and deliberations and has been advised by outside objective advisors, the board must be careful should it determine to proceed in a manner inconsistent with the recommendations of the committee. Should the board choose to do so, it should have appropriate evidence to demonstrate that the board itself has appropriately reviewed the issues. In reviewing the report of the committee, the board must bear in mind that the board as a whole has not undertaken the amount of work or made the level of inquiry that the committee has undertaken. Accordingly, it seems unlikely that a board would

act in a manner inconsistent with the committee's recommendation unless it has determined that the committee process itself was flawed. For example, it is possible that the board might determine that the committee did not consider certain material facts or circumstances relevant to its inquiry that would significantly impact on the committee's recommendation or there may have been a significant disagreement at the special committee level such that the committee's recommendation is itself subject to significant qualifications. Even in these circumstances, the board should consider whether to send the matter back to the committee for further review or potentially establish a new committee to undertake a similar review.

* * *

As can be seen from the foregoing discussion, a special committee may be established in a variety of contexts with each one requiring an analysis of its own set of unique considerations and issues. It is hoped that this discussion can provide directors with some guiding principles that will be of assistance in that process.

William K. Orr
Aaron J. Atkinson

Appendix "A"
Sample Mandate — M&A Transaction

WHEREAS [*describe transaction*] (a "Proposed Transaction"); and

WHEREAS a Proposed Transaction is or may be subject to all or substantially all of the requirements prescribed by Multilateral Instrument 61-101 — *Protection of Minority Security Holders in Special Transactions*; and [*Note: The foregoing paragraph should only be included in a transaction that is or may be subject to the Special Transaction Rules.*]

WHEREAS the board of directors of the Company has determined that it is in the best interests of the Company that the decision of the board as to whether any Proposed Transaction is in the best interests of the Company should be preceded by an analysis of the relevant facts and issues conducted by independent directors and accordingly, it is desirable to establish a committee of independent members of the board, to be referred to as the "Independent Committee"; and

WHEREAS each of [*name committee members*] has advised the board of directors that he or she is independent of [*refer specifically or generically to applicable interested parties*];

BE IT RESOLVED THAT:

1. A committee of independent members of the board of directors, to be known as the "Independent Committee", is hereby constituted and the following persons shall be appointed members of the Independent Committee:

   [*Note: List committee members*]

2. The Chair of the Independent Committee shall be [*name of Chair*].

3. The Independent Committee is constituted for the following purposes:

   a) to receive details of, consider and evaluate any proposal concerning any Proposed Transaction, and discuss such proposal with, representatives of [*interested parties*], the Company and its affiliates and other organizations and experts, consultants and advisors to such parties (the "Representatives");

   b) to consider and advise the board of directors as to whether any Proposed Transaction is in the best interests of the Company, having regard to all considerations determined relevant by the Independent Committee;

   c) without limiting the generality of the foregoing, if thought necessary or advisable by the Independent Committee, to initiate and conduct discussions and negotiations with any third parties regarding any transaction other than any Proposed Transaction which might serve to maximize shareholder value, provided that no commitment to complete any such transaction shall be made without prior approval of the board of directors;

   d) if thought necessary or advisable by the Independent Committee, to canvass with the Representatives any revisions to the structure of any Proposed Transaction that the Independent Committee considers to be necessary or advisable by way of response to matters of concern to the Independent Committee, including negotiations concerning such revisions;

e) if a Proposed Transaction is approved, to review its implementation on behalf of the board of directors;

f) to consider and evaluate the terms and conditions of offers or any other alternative other than a Proposed Transaction that may be made from time to time for or in respect of the shares or assets of the Company;

g) from time to time provide advice and guidance to the board of directors as to matters considered by the Independent Committee to be reasonably ancillary to a Proposed Transaction, together with the recommendations of the Independent Committee with respect thereto; and

h) without limiting the generality of the foregoing, to carry out its obligations under all applicable laws, including, without limitation, applicable corporate and securities laws;

it being understood that the Independent Committee shall be entitled, without further authorization from the board of directors, to consider all matters that it may consider relevant to those listed above.

4. The Independent Committee is hereby authorized to meet with any and all persons, including officers and employees of the Company, and legal, accounting, financial and other advisors and consultants to the Company and the board as the Independent Committee may deem necessary or desirable.

5. Directors, officers, and employees of the Company are hereby directed to cooperate with the Independent Committee and its experts, consultants, and advisors as the Independent Committee may reasonably consider necessary, including, without restriction, through the provision of information concerning the business and affairs of the Company and other entities affected by any Proposed Transaction. Without limiting the foregoing, to assist the Independent Committee in discharging its responsibilities, management of the Company shall identify with the Chair of the Independent Committee any issues concerning the business and affairs of the Company that would be affected by the Independent Committee's work in respect of which information has not previously been sought by the Independent Committee.

6. In carrying out its responsibilities, the Independent Committee shall coordinate and consult (both directly and through its experts, consultants, and advisors) with the board of directors, management and experts, consultants, and advisors of and to the Company, but the Independent Committee shall have control of the timing and manner of such coordination and consultation and the times of and the places where meetings of the Independent Committee shall be held and the calling of and procedures at such meetings shall be determined from time to time by the Independent Committee. The Independent Committee shall be authorized to determine its procedures and rules, including rules governing the recusal of members of the Independent Committee in appropriate instances.

7. In furtherance of its responsibilities hereunder, the Independent Committee may:

a) engage, on such terms and conditions as are approved by the Independent Committee and at the expense of the Company, such experts, consultants, and advisors as the Independent Committee considers appropriate, including legal, financial, and accounting advisors and any member of the Independent Committee is hereby authorized, following authorization by the Independent Committee, on behalf of the Company and in its name, to execute and deliver engagement letters with such experts, consultants, and advisors; and

b) authorize and direct senior management of the Company as to actions on the part of the Company (such as instructions to the experts, consultants, and advisors of the Company) that are made necessary or advisable by reason of the fact that a Proposed Transaction is under consideration, or are necessary or advisable for the proper performance by the Independent Committee of its respon-

sibilities hereunder, including the execution on behalf of the Company of necessary or advisable documents and agreements (such as confidentiality agreements with third parties and compensation and indemnification agreements with experts, consultants, and advisors).

8. The Company shall pay the fees and expenses incurred by the Independent Committee in discharging its duties.

9. Any member of the Independent Committee may be removed or replaced at any time by the board of directors and shall, at any time, cease to be a member of the Independent Committee upon ceasing to be a director of the Company. Any member of the Independent Committee may resign his or her membership on the Independent Committee at any time. Subject to the foregoing, each member of the Independent Committee shall hold office until such time as he or she may be so removed or replaced, ceases to be a director of the Company or resigns from the Independent Committee. The Independent Committee may determine when and whether its responsibilities have been performed and are at an end.

10. Each member of the Independent Committee shall be paid a fee of $[dollar amount] for acting as a member of the Independent Committee and, in addition thereto, meetings of the Independent Committee (including meetings conducted by telephone conference) shall be treated as meetings of a committee of the board of directors and, accordingly, the members of the Independent Committee shall be compensated therefor and for related expenses in accordance with the Company's current practices, the foregoing payment of fees and expenses being in addition to any other fee and expense payments to which such directors are otherwise entitled. [*Note: The foregoing paragraph should be revised as necessary to describe the actual compensation arrangements*.]

11. The Independent Committee and the officers and directors of the Company be, and they hereby are, authorized, empowered, and directed to take any and all actions that may be necessary or appropriate in order to carry out the purposes and intent of the foregoing resolutions.

Appendix "B"
Sample Mandate—Internal Investigation

WHEREAS [*describe facts leading to the need for the investigation*]; and

WHEREAS the board of directors of the Company has determined that it is in the best interests of the Company that a committee of independent members of the board to be referred to as the "Special Committee" be created and authorized to: (i) to conduct an independent investigation, review and assessment and of the allegations, and any other matters that the Special Committee may conclude should be considered (such allegations and matters being referred to collectively as the "Allegations"); (ii) to consider and to take any action(s) determined by the Special Committee to be necessary and appropriate as a result of the Allegations; and (iii) to recommend to the board of directors any other appropriate action that the Company should take in response to the Allegations; and

WHEREAS each of [*name committee members*] has advised the board of directors that he or she is independent of [*refer specifically or generically to applicable interested parties*]:

BE IT RESOLVED THAT:

1. A committee of independent members of the board of directors, to be known as the "Special Committee", is hereby constituted and the following persons shall be appointed members of the Special Committee:

   [*Note: List committee members*]

2. The Chair of the Special Committee shall be [*name of Chair*].

3. The Special Committee is constituted for the following purposes:

   a) to conduct an independent investigation, assessment and review of the Allegations and such other matters as it may conclude should be considered;

   b) to avail itself of any and all documents, materials, work product, and other information prepared or collected by management or employees of the Company, the board of directors or any committee thereof, or their respective advisors;

   c) to take any other action that the Special Committee determines appropriate in its sole discretion, against any director, officer, or employee of the Company based upon the Special Committee's determination regarding the actions of such individual in connection with the Allegations;

   d) without limiting the foregoing, the Special Committee shall recommend to the board of directors any other appropriate action that the Company should take in light of the Special Committee's conclusions regarding the Allegations as the Special Committee deems appropriate and in the best interests of the Company, in accordance with applicable law; and

   e) without limiting the generality of the foregoing, to carry out its obligations under all applicable laws, including, without limitation, applicable corporate and securities laws;

   it being understood that the Special Committee shall be entitled, without further authorization from the board of directors, to consider all matters that it may consider relevant to those listed above.

4. The Special Committee shall make independent determinations and conclusions regarding the Allegations and, accordingly, shall not be bound by any determinations or conclusions reached by the board of directors or any other committee thereof regarding such matters.

5. The Special Committee shall be authorized to determine the procedures and rules governing its investigation, including rules governing the recusal of members of the Special Committee in appropriate instances.

6. Directors, officers, and employees of the Company are hereby directed to cooperate fully with the Special Committee and its advisors, including being interviewed at the request of the Committee or its counsel, or providing the Committee or its counsel with such business, financial and other information regarding the Company as may be reasonably requested by them in conjunction with the performance of their duties hereunder.

7. The Special Committee is directed to report its findings and conclusions to the board of directors in a manner and at such times as counsel to the Special Committee shall determine is consistent with the independence of and charge to the Special Committee.

8. In furtherance of its responsibilities hereunder, the Special Committee may:

    a) engage, on such terms and conditions as are approved by the Special Committee and at the expense of the Company, such experts, consultants, and advisors as the Special Committee considers appropriate, including legal, financial, and accounting advisors and any member of the Special Committee is hereby authorized, following authorization by the Committee, on behalf of the Company and in its name, to execute and deliver engagement letters with such experts, consultants, and advisors; and

    b) authorize and direct senior management of the Company as to actions on the part of the Company (such as instructions to the experts, consultants, and advisors of the Company) that are made necessary or advisable by reason of the fact that the Allegations are under consideration, or are necessary or advisable for the proper performance by the Special Committee of its responsibilities hereunder.

9. The Company shall pay the fees and expenses incurred by the Special Committee in discharging its duties.

10. Any member of the Special Committee may be removed or replaced at any time by the board of directors and shall, at any time, cease to be a member of the Special Committee upon ceasing to be a director of the Company. Any member of the Special Committee may resign his membership on the Special Committee at any time. Subject to the foregoing, each member of the Special Committee shall hold office until such time as he may be so removed or replaced, ceases to be a director of the Company or resigns from the Special Committee. The Special Committee may determine when and whether its responsibilities have been performed and are at an end.

11. Each member of the Special Committee of the board of directors shall be paid a fee of $[*dollar amount*] for acting as a member of the Special Committee and, in addition thereto, meetings of the Special Committee (including meetings conducted by telephone conference) shall be treated as meetings of a committee of the board of directors and, accordingly, the members of the Special Committee shall be compensated therefor and for related expenses in accordance with the Company's current practices, the foregoing payment of fees and expenses being in addition to any other fee and expense payments to which such directors are otherwise entitled. [*Note: The foregoing paragraph should be revised as necessary to describe the actual compensation arrangements*.]

12. The Special Committee and the officers and directors of the Company be, and they hereby are, authorized, empowered, and directed to take any and all actions that may be necessary or appropriate in order to carry out the purposes and intent of the foregoing resolutions.

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About the Authors

William K. Orr

William K. Orr is a Partner with Fasken Martineau DuMoulin LLP. He focuses his practice on corporate governance and specializes in advising boards of directors and independent committees of boards. Bill has been active in securities matters and mergers and acquisitions including multi-national transactions in Canada, the United States, the United Kingdom and other countries. He is a recognized expert in public and private financing, private placements, takeover bids, mergers and acquisitions, going-private transactions, corporate governance, restructurings, and stock exchange and securities enforcement issues. His clients include boards and independent committees of boards of directors, public companies, investment dealers and institutional investors.

He has taught courses in securities regulation and business law at Queen's University, Osgoode Hall Law School, McGill University and the University of Toronto Faculty of Law and has participated in many conferences and seminars and written extensively on securities regulation. He has the ICD.D designation of the Institute of Corporate Directors.

Bill has served on a number of community and charitable boards of directors, including:

- Director, Institute of Corporate Directors
- President, Family Service Association of Metropolitan Toronto
- Chair, Board of Trustees, Trinity College, University of Toronto
- Chair, Board of Directors, Dellcrest Children's Centre
- Member, College of Electors of the University of Toronto
- Director and Honourary Counsel, The Duke of Edinburgh's Award — Young Canadians Challenge

Aaron J. Atkinson

Aaron J. Atkinson is a Partner with Fasken Martineau DuMoulin LLP. He focuses his practice primarily on mergers and acquisitions, corporate governance and corporate finance. In each of these areas, Aaron has extensive experience advising clients in both domestic and international cross-border matters in a variety of industries. Aaron's practice includes advising boards and board committees in each of his practice areas, including in contested take-over transactions, proxy contests, internal investigations and day-to-day governance matters. Aaron also serves as a sessional instructor at the University of Windsor Faculty of Law where he has organized and taught a course in corporate finance and M&A since 2007. He is also a frequent speaker at seminars and conferences on current issues in each of his practice areas. Aaron is recognized in Chambers Global: The Guide to the World's Leading Lawyers for Business as a leading lawyer for Corporate/M&A.

20 Questions Directors Should Ask about **Special Committees**

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277 Wellington Street West
Toronto, ON Canada M5V 3H2
416.977.3222 www.cica.ca