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Ontario Securities Commission  
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Registrar of Securities, Government of Yukon  
Registrar of Securities, Department of Justice,  
Government of Northwest Territories  
Securities Commission of Newfoundland and Labrador  
Nova Scotia Securities Commission  
Commission des valeurs mobilières du Québec  
Saskatchewan Financial Services Commission  
Office of the Attorney General, Prince Edward Island  
Registrar of Securities, Legal Registries Division,  
Department of Justice, Government of Nunavut  
Department of Justice, Securities Administration Branch, New Brunswick

Ontario Securities Commission  
20 Queen Street West  
Suite 1900, Box 55  
Toronto, Ontario M5H 3S8

**ATTENTION: Mr. John Stevenson, Secretary**

Dear Mr. Stevenson:

**RE: The Investor Confidence Rules and the Proposed Multilateral  
Instrument 52:110 Audit Committees**

We are pleased to provide our comments in response to the Canadian Securities Administrators' ("CSA") Proposed Investor Confidence Rules including the Multilateral Instrument 52-110 - Audit Committees (the "Proposed Instrument").

**Corporate Profile**

Sears Canada is a multi-channel retailer with a network of 123 full-line stores, 46 Sears Home stores, over 2,200 catalogue merchandise pick-up locations, 144 dealer stores, 14 outlet stores, 51 floor covering centres, 50 auto centres, 110 Sears Travel offices and a nationwide maintenance, repair, and installation network. Sears Canada also publishes the Country's most extensive general merchandise catalogue and offers shopping online at [www.sears.ca](http://www.sears.ca). Through its community investment program, the Sears Young Futures Fund, the company supports organizations that offer enriching after-school programs that inspire children and youth to believe in themselves.

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The authorized share capital of Sears Canada consists of an unlimited number of Common Shares and an unlimited number of Class 1 Preferred Shares, issuable in series. There are currently no Class 1 Preferred Shares outstanding. As at September 30, 2003, the issued and outstanding share capital of the Corporation consisted of 106,794,745 Common Shares, currently traded on the Toronto Stock Exchange ("TSX"). Sears, Roebuck and Co. is the beneficial holder of approximately 54% of the outstanding Common Shares of Sears Canada.

### Background

The central concern we wish to express deals with the recommendation set out in the Proposed Instrument that Audit Committees should be composed of entirely independent directors.

The relevant draft rule reads as follows:

#### *1.4 Meaning of Independence*

- (1) A member of an Audit Committee is **independent** if the member has **no direct or indirect material relationship** with the issuer.
- (2) For the purposes of subsection (1), a material relationship means a relationship which could, in the view of the issuer's board of directors, reasonably interfere with the exercise of a member's independent judgement.
- (3) Despite subsection (2), the following persons are considered to have a material relationship with an issuer:
  - (a) a person who is, or whose immediate family member is, or at any time during the prescribed period has been, **an officer or employee of the issuer, its parent**, or of any of its subsidiary entities or affiliated entities.

(emphasis added)

#### *3.1 Composition*

- (1) An Audit Committee must be composed of a minimum of three members.
- (2) Every Audit Committee member must be a director of the issuer.
- (3) ***Subject to sections 3.2, 3.3, 3.4, 3.5, every Audit Committee member must be independent.*** (emphasis added)

- (4) Subject to section 3.5, every Audit Committee member must be financially literate.

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### 3.3 *Controlled Companies*

An Audit Committee member that sits on the board of directors of an affiliated entity is exempt from the requirement in subsection 3.1(3) if that member, except for being a director (or member of the Audit Committee or any other board committee) of the issuer and the affiliated entity, is otherwise independent of the issuer and the affiliated entity.

#### Commentary

We understand that the purpose of the independence requirements is to ensure that the Audit Committee is independent of management.

The definition of independence precludes controlling shareholders and their employees from sitting on the Audit Committee. We note the exception that a member of the controlling shareholder's board who is independent of the controlling shareholder and the public company subsidiary may sit on the subsidiary's audit committee.

The TSX's guidelines on corporate governance have a similar provision. Section 5.12 of the December 1994 *Report of the Toronto Stock Exchange Committee on Corporate Governance in Canada* states that "a director who is a significant shareholder or a director with interests in, or relationships with, the significant shareholder should not be considered a related director" for the purposes of the TSX guidelines. Shareholding alone will not make a director "related".

We believe that a controlling shareholder has a compelling interest in ensuring strong oversight of financial reporting and the audit process and reasonably ought to expect that its interests will be represented on the board and on the Audit Committee of the companies in which it holds a controlling position. There are advantages to including the Chief Financial Officer of the controlling shareholder as a member of the Audit Committee of the controlled subsidiary. In light of the fact that a controlled subsidiary's financial results are consolidated with the financial results of its controlling shareholder, it is proper that the controlling shareholder exercises due diligence and proper supervision over the compliance with the relevant accounting policies. The mandatory certification of the financial statements by a U.S. controlling corporate shareholder underscores this responsibility.

One additional safeguard could be considered whereby the independent members of the Audit Committee would be required to have regular *in camera* sessions following each meeting without the presence of the controlling shareholder's representative. Any unresolved issues or concerns would be taken up with the lead director of the subsidiary and the external independent auditors..

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The exemption provided by section 3.3 of the Proposed Instrument fails to adequately address the interests of controlling shareholders since its application is limited solely to a director who is otherwise independent of each affiliate on which the director sits.

The exemption in section 3.3 should be broadened to **permit employees of the controlling shareholder** to participate on the Audit Committee of the controlled subsidiary.

In fact, it has been our experience that having the Chief Financial Officer of Sears, Roebuck as a member of the Sears Canada Board of Directors and its Audit Committee, contributed a tremendous additional value to the quality of the process. The Chief Financial Officer of Sears, Roebuck has always possessed the requisite qualifications and financial expertise. The Independent Directors comprising the Audit Committee have consistently expressed their interest and support in having such a person participating at every Audit Committee meeting and in the decision making process serving the interests of all shareholders.

(sgd.)

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