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Director General
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235 Queen Street, 10th Floor
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Re: Request for Comment – Consultation on the *Canada Business Corporations Act* (CBCA)

Thank you for the opportunity to comment on the Consultation Paper, “Consultation on the *Canada Business Corporations Act*” published by Industry Canada on December 11, 2013. We applaud Industry Canada’s efforts to revitalize provisions within the CBCA.

By way of introduction, this letter is a collaboration of two authors:

Carol Liao is an Assistant Professor (incoming as of July 2015) in the Faculty of Law at the University of Victoria, and is currently completing a combined PhD/SJD in the Faculty of Law at the University of British Columbia and the Faculty of Law at the University of Toronto. Prior to her graduate studies, she was a senior corporate associate at Shearman & Sterling LLP in New York. Her research focuses on Canadian comparative corporate law and governance, including the global emergence of socially responsible enterprises. She has recently completed a qualitative study where 32 leading senior legal practitioners across Canada were interviewed on the fundamental principles that are driving the development of Canadian corporate governance today. The Institute of Corporate Directors email broadcast this study, entitled “A Canadian Model of Corporate Governance: Insights from Canada’s Leading Legal Practitioners,” to its 7,500 director members on November 14, 2013. The report is available online at <http://ow.ly/v0I8x>.

Rebecca Johnson is a Full Professor in the University of Victoria Faculty of Law. After completing degrees in Music, Management, and Law (BMus, MBA, LLB), she was a law clerk to Madame Justice Claire L’Heureux-Dube at the Supreme Court of Canada. She received her LLM and SJD from the University of Michigan. Her book *Taxing Choices: The Intersection of Class, Gender, Parenthood and the Law* (2002) explored the intersection of privilege and disadvantage in the context of child care tax deductions. She is one of the co-editors of *Storied Communities: Narratives of Contact and Arrival in Constituting Political Community* (2011). A focus on the relationship between law and society informs her teaching and scholarship. She currently teaches Business Associations, Criminal Law, and Law-and-Film, and is a member of the Advisory Board of the Centre for Co-operative and Community-Based Economy.

Before commenting on the specific issues outlined in the Consultation Paper, we would like to make some general comments on the role of the legislature, courts, securities commissions, and other groups in the development of Canadian corporate law.

It has been 13 years since the CBCA has been comprehensively revised, and during that period there have been significant shifts in Canadian governance standards by Canadian courts and other regulatory bodies. While theoretically it is the legislators and the courts that should be leading the development of corporate law in Canada, the pace of legislative reform has meant that legislators have not been well-equipped to deal with the changing corporate environment. Substantial corporate cases in Canada are also few and far between, meaning Canadian courts do not have the instrumentalities to promote good behaviour. Thus, while the legislature and the courts can and should be providing the critical foundations for our corporate laws, in recent history they have not proven to be robust methods of helping governance practices evolve in Canada. For reformers, this consultation process is long awaited and provides legislators with the opportunity to ensure that Canadian governance moves along the desired path of development.

Whether by choice or through the process of elimination, in the last decade the securities commissions have taken considerable liberties in exercising their “public interest” jurisdiction to influence the development of governance due to the void in Canadian governance leadership. The commissions are now playing a major role in shaping Canadian corporate governance practices. The dominance of securities commissions in Canadian governance has led to several consequences, some of which have been immensely positive for Canadian corporate development – such as the enhancement of shareholders’ rights in particular areas – and other consequences that have been negative. Those negative consequences in particular stem from the overwhelming preference for shareholders’ voting rights over other fundamental principles that have formed the building blocks of Canadian corporate law since the CBCA’s implementation in 1976 and have been further developed within our common laws, particularly with regard to the fiduciary duties of directors and the consideration of broader stakeholder interests in corporate decision-making.

The way in which Canadian corporate laws have been formed by the legislature, and have been interpreted by the courts, indicates that Canada has a more flexible model of governance which incorporates the consideration of non-shareholder stakeholder interests in corporate decision-making. Some of the building blocks of Canadian corporate governance include the fact that Canadian legislation requires directors to act in the “best interests of the corporation” as opposed to the “best interests of the shareholders.”¹ Canada is also fairly unique in its oppression remedy.² Landmark decisions by the Supreme Court of Canada have emphasized these statutory differences, particularly the 2008 decision of *BCE Inc. v. 1976 Debentureholders*,³ causing many practitioners to inform boards that they can – and indeed should – take into account non-shareholder value issues. Stakeholder interests may have always had a role in governance under Canadian statutory laws, but the courts have now generated a need for boards to document their process of considering those interests.

¹ S. 122 of the *Canada Business Corporations Act*, R.S.C., 1985, c. C-44 [CBCA].

² S. 241 of the CBCA.

³ *BCE Inc v 1976 Debentureholders*, 2008 SCC 69.

Despite the fact that Canadian statutes and common law have tended to favour a more stakeholder-friendly model that assumes greater board control in its fiduciary duties to the best interests of the corporation,⁴ securities regulators have increased shareholders' rights well beyond what has ever been contemplated under Canadian corporate law. By design, the securities commissions are created for the purpose of protecting investors, and their influence has pushed Canada toward a "shareholder primacy" model of governance. What is troubling is that the commissions' interpretation of protecting investors' rights has tended towards lessening the impact of directors – those that have a fiduciary duty to protect investors' rights – and to place greater control at the hand of shareholders' votes. Furthermore, the commissions have often disregarded findings from the courts, are not well-versed in evidentiary rules, and often fail to establish principles that can guide lower courts.

As Industry Canada contemplates the comments that are being submitting in this consultation process, it may be well-served to consider the broader picture behind Canada's corporate legal landscape, and the implications of amendments in relation to that broader picture.

Below are our comments on select issues addressed in the Consultation Paper:

(1) Voting

(a) individual election of directors and "slate" voting

We are in support of CBCA amendments allowing for the individual election of directors and prohibiting "slate" voting. Canadian corporate law is premised on shareholders' right to vote in the election of directors, which offers the shareholders limited 'control' in that they are empowered to vote for the directors that have a fiduciary duty to the company, and vote them down at the next election if they are unhappy with their performance. Individual elections allow for greater board accountability as opposed to an all-or-nothing option, enhance shareholders' voting rights where it is warranted, and complement our view that greater board control in Canada is needed.

(b) maximum one-year terms and annual elections for directors

We are opposed to the elimination of staggered boards and implementation of annual elections for directors. Staggered boards allow for corporations to have better mission control, continuity, stability, and long-term vision. Annual elections would hamper directors' abilities to focus on the long-term as there would be heightened expectations to produce positive results in a short period of time (which, in the eyes of shareholders more often than not equates to meeting quarterly earnings targets, and works to the detriment of increasing value in the company⁵). Long-term

⁴ Research has shown that the consideration of broader stakeholder interests in corporate decision-making is the most successful method of increasing overall value within a company, particularly with respect to increasing shareholder value. See i.e. R. Edward Freeman, *Strategic Management: A Stakeholder Approach* (Cambridge: Cambridge University Press, 2010); and Robert G. Eccles, Ioannis Ioannou, and George Serafeim, "The Impact of Corporate Sustainability on Organizational Processes and Performance" *Management Science* (forthcoming) (which found that high sustainability firms dramatically outperformed the low sustainability ones, providing a 4.8% greater return per year in an 18 year period).

⁵ See i.e., John R. Graham, Campbell R. Harvey, and Shivaram Rajgopal, "Value Destruction and Financial Reporting Decisions" (2006) 26 *Financial Analysts Journal* 27 (where 55% of surveyed CFOs indicated that they

vision of capital needs to be protected, as has been emphasized by the joint initiative of Mark Wiseman, the President and CEO of the Canadian Pension Plan Investment Board, and Dominic Barton, the Global Managing Director of McKinsey & Company, to facilitate “focusing on capital on the long term.”⁶

(c) “empty voting” by shareholders without an economic interest in the corporation

Proper corporate governance has long been premised on a proportional relationship between economic interest and shareholder votes of ‘one share, one vote.’ This relationship gives shareholders the incentive to exercise their voting power responsibly and legitimizes directors’ roles through elections. We favour legislation requiring the coupling of voting and equity interests.

In the 2012 case of *TELUS Corporation v. CDS Clearing and Depository Services Inc.*,⁷ the BC Supreme Court recognized the dangers of empty voting in no uncertain terms, noting:

Shareholder democracy rests on the premise that shareholders have a common interest: a desire to enhance the value of their investment. Even when shareholders have different investment objectives, the shareholder vote is intended to reflect the best interests of the company in the pursuit of wealth maximization.

When a party has a vote in a company but no economic interest in that company, that party’s interests may not lie in the wellbeing of the company itself. The interests of such an empty voter and the other shareholders are no longer aligned and the premise underlying the shareholder vote is subverted....In extreme examples, empty voters may even be adverse in interest to other shareholders...⁸

On appeal, the Supreme Court’s ruling was overturned. On behalf of the appellate court, Justice Groberman noted that “courts are entitled to intervene only when they have specific authority to do so under statutory provisions⁹ and that “...[t]o the extent that cases of ‘empty voting’ are subverting the goals of shareholder democracy, *the remedy must lie in legislative and regulatory change* [emphasis added].”¹⁰ We therefore believe it is necessary for legislative intervention to rectify the empty voting issue, and encourage Industry Canada to actively consider legislating the coupling of equity and voting interests.¹¹ We do not believe disclosure alone is an adequate response to empty voting.

would forego an attractive capital investment project today if the investment led them to even marginally miss their quarterly earnings targets).

⁶Dominic Barton and Mark Wiseman in “Focusing Capital on the Long-Term,” online: CCPIB <www.cppib.com>.

⁷ *TELUS Corporation v. CDS Clearing and Depository Services Inc.*, 2012 BCSC 1350.

⁸ *Ibid.* at paras. 104-106.

⁹ *TELUS Corporation v. Mason Capital Management LLC*, 2012 BCCA 0403 at para. 74.

¹⁰ *Ibid.* at para. 81.

¹¹ Empty voting is a complicated issue as it can take many forms, and these forms need to be better understood in order for there to be proper regulation. We recommend a review of Henry Hu and Bernard Black, “Empty Voting and Hidden Ownership: Taxonomy, Implications, and Reforms” (2006) 61 *Business Lawyer* 1011, which provides insights on substantive responses to empty voting.

(2) Incorporation of Socially Responsible Enterprises (SREs)

Industry Canada has asked for consultation as to the utility of SREs in the Canadian context and the extent to which current CBCA incorporation provisions and structures facilitate the creation of SREs. SREs could potentially serve as a useful corporate tool in Canada, but the success or failure of SREs are entirely dependent on the individual structure of each SRE under consideration (particularly relative to other existing corporate alternatives), as well as other reasons beyond legal rules.

Within the last decade, several new corporate hybrids have appeared on the global stage, including the ‘community interest company’ (CIC) in the United Kingdom, and the ‘low profit limited liability company’ (L3C) and ‘benefit corporation’ in the United States. It is our belief a Canadian SRE, modeled after the UK CIC, may offer potential benefits to the Canadian social economy, but there are important questions that would first need study, regarding the context in which the model would be best placed to gain sufficient traction in Canada. In terms of the other two US SREs – the L3C and benefit corporation – we believe these SREs would not prove to be worthwhile. Each of these models is addressed in turn.

(a) UK Community Interest Company (CIC) / BC Community Contribution Company (C3)

CICs are designed to enable and encourage the investment of private wealth into community projects. Given the asset lock and the dividend cap, the CIC tends to be more attractive for those currently situated in the non-profit sector. Since a CIC structure allows capital to be raised through the issuance of shares, it creates economic opportunities that have traditionally been closed off to charitable and non-profit organizations.

BC and Nova Scotia legislators may be relying on the relative success the CIC has had in the United Kingdom. Based on the number of new starts, UK CICs have doubled in the last two years to 2013, and some reports suggest that over 100 new CICs are registered every month.¹² In its nine years of existence, there are now over 9,300 CICs.¹³ In sheer numbers, this means there are now more associations registered in the CIC form than in the co-operative ownership form. Of course, the nearly 6000 independent co-operatives in the UK represent 13.5 million members and £35.6 billion of the UK economy.¹⁴ Though a considerable number of CICs have survived the three-year mark, there are not yet equally robust statistics on the CICs’ monetary contributions to the UK economy, the average size of CICs, or total members. At this point, it is clear that it would be useful to pay considerable attention to the CIC form, and consider the conditions that are linked to its flourishing in the UK context.

There are many reasons beyond legal ones that dictate the success of new business forms, and BC’s adoption of a CIC model may provide some cautionary notes. In the UK, the rollout of the CIC model was embedded in significant infrastructural and regulatory support. The BC

¹² CIC Association, “What is a CIC?,” online: <www.cicassociation.org.uk/about/what-is-a-cic>.

¹³ Regulator of Community Interest Companies, “Annual Report 2011/2012,” online: <www.bis.gov.uk> at 13. 590 CICs were also dissolved, with key reasons for dissolution being “lack of funding, no trading activity, and poor corporate governance.”

¹⁴ Co-operatives UK, “About Co-operatives,” online: <www.uk.coop/co-operatives>.

government has taken precisely the opposite approach, and made it clear that they have no funding to regulate, promote, or educate the public on this model. It may be that this choice explains why, as of April 28, 2014, only 14 C3s were registered in BC. With the lack of infrastructure and governmental oversight in the BC hybrid, it is unclear whether this model will gain significant support from entrepreneurs. If Industry Canada were to pursue a federal version of the BC C3 model, it should adopt the example of the UK CIC in terms of providing the necessary support to enable the success of such a model. Effective promotion, education, and regulation of the C3 model, as well early incentives, such as an initial pool of social finance to gain a critical mass of early adopters, would likely be the minimum necessary for this model to catch on. The importance of such an approach is also visible in the government's explorations of the conditions of success for the co-operative model.¹⁵

Given the success of the UK CIC, an investment into such a model could potentially be worthwhile in enhancing Canada's social economy. It is important to note, however, that there is very little research documenting the reasons behind the exponential growth of the UK CIC, and some of those reasons may relate to issues that are very UK-specific and would not translate well into other countries. The slow start of the BC model should give Industry Canada pause, but also foster the development of further research on this SRE as situated within a Canadian context.

(b) US Low Profit Limited Liability Company (L3C)

The L3C, implemented in some US states starting in 2008, is in many ways an unsuccessful SRE model. It is a very specific hybrid that was designed to simplify Internal Revenue Service (IRS) rules regarding the issuance of program-related investments by charitable foundations, mainly by adopting IRS language in its governing documents. Early drafters had hoped for a blanket IRS private letter ruling acknowledging this hybrid, but the IRS has been silent on the matter, and two attempts at passing bills before Congress to recognize the hybrid have failed. The model has been ineffective as a result; its numbers have peaked at around 800, and it is highly unlikely there will be further growth.¹⁶

(c) US Benefit Corporation

The potential implementation of a benefit corporation in Canada raises some immediate concerns regarding redundancy when compared to Canadian corporate laws. The most significant legal feature in the benefit corporation is the requirement that directors consider stakeholder interests in their decision-making. This feature echoes what is already available under Canadian laws, specifically under the requirement that directors manage the corporation in the "best interests of the corporation," and findings from the *BCE* decision regarding the consideration of stakeholder interests. The effect of the *BCE* decision has made this particular requirement to consider stakeholder interests much more potent, as directors feel the pressure to document and record evidence of the process they took to consider stakeholders' interests in their decisions. We would

¹⁵ See e.g., "Status of Co-operatives in Canada," Report of the Special Committee on Co-operatives (September 2012), online: Parliament of Canada <www.parl.gc.ca>, finding that a lack of knowledge by institutions on the co-operative business model has significantly impeded access to financial capital. Again, this emphasizes that support for education is at least as important as modifications to the regulatory regimes.

¹⁶ InterSector Partners L3C, "Here's the latest L3C tally" (8 March 2013) online: <www.intersectorl3c.com/l3c_tally.html> (numbers based on active L3Cs reported by Secretaries of State).

highly recommend that Industry Canada codify the requirement that directors are to consider stakeholders in their corporate decision-making, to eliminate the ambiguity caused in the *BCE* decision as to whether this is a permissive or mandatory obligation.

On the stakeholder requirement alone, the Canadian model of governance is already more stringent than the legal offering by the benefit corporation. This is in addition to the SCC's comment in *BCE* that directors are to look to the best interests of the corporation "viewed as a good corporate citizen." If there is any legal import to be taken behind those words, then in that sense, all Canadian corporations should be acting as benefit corporations.

The court in *BCE* also specifically validated the business judgment rule. Provided that the board's decision is within a range of reasonable alternatives, the court will always defer to that judgment. Directors pursuing dual mandates are well protected under Canadian corporate laws.

Since the question being examined is in regard to the added value of implementing benefit corporation legislation in Canada, there does not seem to be any added legal features in the benefit corporation that would combat any of the pressures that exist for the regular Canadian public corporation. The model benefit corporation legislation requires a benefit director to be on the publicly traded benefit corporation's board – which one would assume is only meant to identify the specific tasks beholden to the benefit director and not the inherent reflection of a unique intent behind the benefit director's decision-making, as all directors are beholden to their fiduciary duties.¹⁷ Other than this feature, there are no other protections offered to support the social benefit side of the benefit corporation in a public company context. The legislation is not equipped to counter the pressures that public companies face on the global capital markets. Public benefit corporations would still be subject to National Policy 62-202 regarding takeover bids and defensive tactics. Benefit corporations would have the exact same issues as all other public companies in that regard.¹⁸

When the stakeholder requirements are stripped away from the benefit corporation structure, the remaining legal elements seem somewhat bare. The requirement that a benefit corporation create "a general public benefit measured by a third party standard" seems impressive at first glance, but a cursory glance at the benefit corporations listed on the Benefit Corporation Information Center's directory indicates that there are would be very few businesses, if any, that would be excluded from this standard.

The last two elements of the benefit corporation are its benefit enforcement proceedings, and its annual reporting requirements. The benefit enforcement proceeding is less stringent than the oppression remedy, which is available to stakeholders against majority shareholders, and derivative actions claims which can be made against directors for violating their duties to the corporation. This is in addition to protections under Multilateral Instrument 61-101 in a public company context. The legislation does indicate that proceedings can be brought against directors for failing to pursue a public benefit, but as earlier stated, there are inherent problems with the definition of public benefit, thus it would seem unlikely anyone would be able to bring a valid

¹⁷ This is reflected in the model benefit corporation legislation, but not necessarily in every state benefit corporation's laws. See Benefit Corporation Information Centre, "Model Legislation" online: <<http://benefitcorp.net/for-attorneys/model-legislation>>.

¹⁸ To date, there are no benefit corporations that are public companies.

claim under that provision that would not already be captured under other tortious claims.

Regarding the annual benefit reporting requirement, public companies have their own disclosure requirements that presumably would capture much of the content within the benefit corporation's reporting requirements, but private companies do not have such requirements. Therefore, this legal feature does offer something that private Canadian companies seeking to pursue both economic and social value do not have, although they certainly can provide such as report if desired. The reporting standards are not substantial.

Overall, there is a concern that the benefit corporation may resort to a branding exercise if it is implemented in Canada. There are no meaningful teeth behind the benefit corporation legislation, and its offerings to Canadian corporate law are minimal. In fact, some of its standards are weaker. Even worse, the adoption of the benefit corporation may only confuse or misrepresent the current state of Canadian corporate laws. If the hybrid is regarded as a clear alternative to the mainstream corporate model, there is a risk that entrepreneurs may erroneously think that they are not able to pursue both social and economic value in their businesses without running some sort of legal risk. That would hinder the very social goals that presumably leaders behind the benefit corporation are trying to achieve.

The benefit corporation has not had exponential success in the United States to date, so there are good reasons for Canada to wait and see how it fares. Indeed, discussions are bubbling up in the US as well, as more practitioners are beginning to pay attention and question the relevance of the benefit corporation in states with "other constituency" statutes, among other nuances in its corporate laws.¹⁹

(3) Corporate Social Responsibility (CSR)

The Supreme Court of Canada in *BCE* held that directors were "not confined to short term profit or share value," but that, where the corporation is an ongoing concern, directors were to look to the long-term interests of the company, and the context of this duty varied with the situation at hand.²⁰ The court also reinforced its support for the business judgment rule. Moreover, the court held that directors were required to act in the best interests of the company "viewed as a good corporate citizen" and "commensurate with the corporation's duties as a responsible corporate citizen."²¹ The court did not elaborate further in their concept of good corporate citizenry.

While increased CSR disclosure is a viable option that we support, and Canada should look to the recent requirements implemented by the European Union on large companies reporting on sustainability factors in their annual financial reports, we are of the belief that all corporations should be responsible corporations. We would reiterate our recommendation in the previous section that Industry Canada codify the requirement for directors to consider non-shareholder stakeholders in their fiduciary duties to the best interests of the corporation, which would eliminate any ambiguity as to what has already been affirmed in statutory and common law. We also strongly favour the codification of CSR objectives in the CBCA, and support the reasons

¹⁹ Noam Noked, "Benefit Corporations vs. Regular Corporations: A Harmful Dichotomy" The Harvard Law School Forum on Corporate Governance and Financial Regulation (13 May 2012), online: <<http://blogs.law.harvard.edu>>.

²⁰ *Ibid* at para 38.

²¹ *Ibid* at paras 66 and 82.

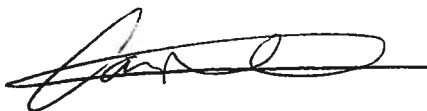
listed within the Consultation Paper as to why CSR is important as well as why such codification would be highly desirable for the future of Canadian corporations.

Final Comments

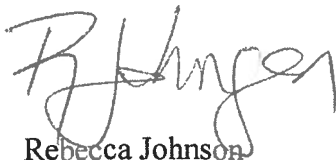
Industry Canada may need to be deferential to the jurisdictions that have been overtaken by securities commissions or other bodies such as the TSX in certain instances, but on the other hand, there are areas where Industry Canada must take the lead in forming the laws that govern Canada's corporations. Canada's corporate laws need to be modernized to reflect Canada's leading position in good governance practices, as set by those in the legislature and the judiciary who have the mandate to consider the development of Canadian corporations as a whole, and not just in relation to its investors. Industry Canada should seek to offer carefully engineered corporate structures that will put Canada in the forefront of corporations best equipped to deal with future economic, social, and environmental challenges. While legislators have taken a back seat in corporate governance reform in that last decade, that is no reason to shy away at this juncture in corporate legal history.

We welcome any questions or further discussion, and thank you for the opportunity to comment.

Kind regards,



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