Bennett Jones

Bennett Jones LLP
3400 One First Canadian Place, PO Box 130
Toronto, Ontario, Canada M5X 1A4
Tel: 416.863.1200 Fax: 416.863.1716

**Gary Solway**
**Partner**
Direct Line: 416.777.6555
e-mail: solwayg@bennettjones.com

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**VIA EMAIL: cbca-consultations-lcsa@ic.gc.ca**

Director General
Marketplace Framework Policy Branch
Industry Canada
235 Queen Street, 10th Floor
Ottawa, Ontario
K1A 0H5

Dear Director General:

**Re: Submission Regarding the 2013/4 Consultation on the *Canada Business Corporations Act***

This submission is made by Bennett Jones LLP ("**Bennett Jones**") in response to the Consultation (the "**Consultation**") published on December 11, 2013 requesting comments on a range of corporate governance matters relating to the *Canada Business Corporations Act* ("**CBCA**") set forth in the published discussion paper. We thank you for the opportunity to make this submission.

Bennett Jones has over 400 professionals with offices in Calgary, Edmonton, Ottawa, Toronto, Washington, D.C., Beijing, Doha and Dubai. Our legal practice encompasses virtually every sector of business and industry. In preparing this submission, we have canvassed certain lawyers from the Corporate Commercial, Capital Markets and M&A, Private Equity and Tax practice groups at Bennett Jones.

Our clients comprise a wide cross-section of Canadian industry and commerce, from public companies operating in the natural resources sector to entrepreneurs in the technology sector. We act on behalf of corporations, as independent counsel to boards of directors and committees of boards of directors, institutional shareholders, investment funds, banks, lending institutions and public market participants. Accordingly, we are very familiar with the respective duties, challenges, priorities and reasonable expectations of directors, senior management, shareholders and other corporate stakeholders and the resultant importance of corporate governance balance pertaining to the fair, effective and efficient operations of CBCA corporations.

It is important that the CBCA should continue to foster a legal framework that permits federal companies to be domestically and internationally competitive and permits boards of directors to perform their fiduciary duties to the corporation for the effective management of the corporation with the concurrent preservation of the legal rights of shareholders. The CBCA should be clear, flexible, efficient and permissive, rather than restrictive or prescriptive. We think certain technical, administrative and fundamental changes to the CBCA should be considered.

The purpose of a corporate statute is to create a framework which permits corporations to conduct their business effectively, efficiently and fairly, and the implementation of arrangements for the performance of the directors' rights, obligations and duties in the best interests of the corporation while protecting the rights of shareholders and other stakeholders in the evolving principles of corporate law.

Most CBCA corporations are small to medium-sized privately-owned enterprises ("**SMEs**"), rather than publicly-traded corporations. Our experience working with owners and managers of businesses of all sizes, particularly SMEs, indicates that they would welcome amendments to the CBCA that promote flexibility and minimize compliance costs. The comments in our submission reflect this perspective and recognize that the provinces' securities authorities and Canada's stock exchanges are well-placed to consider issues particular to public companies and public markets.

Completed from the perspective of practicing lawyers in the field of corporate law, Appendix A of this submission provides our response to certain inquiries made in the Consultation, and has been formatted as responses to such inquiries. Although we have not attempted to address every administrative or technical change that should be contemplated, we have also attached in Appendix B various suggestions not included in the Consultation that we think should be considered.

The views expressed herein are those of the lawyers at Bennett Jones LLP that were canvassed in preparing this submission and are not intended to reflect the views of all of the lawyers at Bennett Jones LLP or any clients of the firm.

We would be pleased to discuss our submission with you should you wish to do so.

Yours truly,

**BENNETT JONES LLP**

Gary Solway

GS/ca

cc: Kahlan Mills
Russel Drew
James McClary

# Appendix A

## I. Executive Compensation

*The Committee recommended that consultations be conducted on the Canada Business Corporations Act with respect to the following compensation matters:*

- *shareholder advisory votes on compensation packages*
- *respective roles of federal and provincial jurisdictions on this issue*

Corporate boards of directors are entitled to fix the compensation levels of directors, officers and employees under section 125 of the CBCA. Additionally, disclosure of executive compensation for public companies[1] is required by National Policy 51-102 – *Continuous Disclosure Obligations* and corresponding provincial securities legislation. Corporations may voluntarily adopt a regime requiring shareholder approval of executive compensation packages ("**say-on-pay**").

The voluntary say-on-pay regime currently in effect reflects the corporate environment in Canada. An increasing number of Canadian public companies have been voluntarily adopting say-on-pay. As of February 3, 2014, according to the Shareholder Association for Research & Education (SHARE), 128 public companies in Canada had voluntarily adopted say-on-pay. This trend is likely to continue.

However, a mandatory say-on-pay regime is inconsistent with the approach of the Canadian Securities Administrators (the "**CSA**"), unnecessary for private companies whose shareholders are closer to management than those of public companies, and would infringe the role of Canadian directors in fixing executive compensation. Directors are better situated than shareholders to determine executive compensation because directors are both privy to information that, for reasons of confidentiality, shareholders may not have access to and because directors are subject to both duties of loyalty and care. If shareholders are displeased with the governance by the board of directors, they have the right to remove directors.

Since say-on-pay is most relevant to public companies, any legislation regarding say-on-pay is best left to the CSA and the provincial securities authorities.

## II. Shareholder Rights

### A. Voting

*The Committee recommended further consultation on the following issues related to voting rights under the CBCA:*

- *mandatory voting by ballot at shareholder meetings and disclosure of results by public companies*

[1] We use the term public companies to refer to corporations and other entities that are reporting issuers in one or more jurisdictions in Canada.

We agree.

- *individual election of directors and "slate" voting*

We agree that the CBCA should require individual voting for directors of public companies which will presumably have the effect of increasing director effectiveness. We note that public companies listed on the Toronto Stock Exchange ("**TSX**") are already required to elect directors individually and to disclose by press release the voting results for the election of its directors.

- *maximum one-year terms and annual elections for directors*

We submit it is unnecessary to change the current provisions of the CBCA that set the maximum term for directors at three years. Shareholders can always remove directors at any time by requisitioning a meeting and voting them out of office. It is relatively uncommon for directors to be elected for terms in excess of a year but we see no reason to prohibit it in appropriate circumstances, whether for public or private companies.

Corporate law in Delaware and other US states is different in this regard, in that shareholders do not always have the right to remove directors without cause. Typically, shareholders of a Delaware corporation with a staggered board will *not* have the right to remove shareholders without cause,[2] meaning that it can take up to three annual meetings to replace all directors.

- *director election by majority vote*

We do not believe that corporate law statutes should require that directors be elected by majority vote, which could result in no directors being elected and therefore risks creating a situation where the current directors select the incoming directors. This is not an ideal outcome from a corporate governance perspective. As well, many shareholders of public companies do not vote at shareholders meetings that just deal with routine matters, so it is often hard to know if the lack of support for a particular director reflects the views of a majority of shareholders, or just a majority of a small number of shareholders who are peculiarly incentivized to vote on the matter. We note, however, that amendments to the TSX rules related to director elections have been approved, which (i) require each director of a TSX-listed entity to be elected by a majority of the votes cast by shareholders other than at a contested shareholders' meeting, and (ii) require each TSX-listed entity to adopt a majority voting policy unless it satisfies the majority voting requirement to the satisfaction of the TSX through its articles or by-laws. The amendments will come into force on June 30, 2014. Any director of a TSX-listed public company that does not receive majority support will be required to resign. We do not think any further regulation is required in this area.

*In addition to the voting issues identified by the Committee, other issues related to shareholder voting rights have attracted stakeholder attention:*

- *"overvoting" of voting rights attached to corporate shares*

[2] See section 141(k)(1) of the Delaware *General Corporation Law*.

This issue is only relevant to public companies. There are conflicting views among public market participants and professional advisors as to whether this represents a material issue. Unless the Director (under the CBCA) is prepared to undertake an in-depth review and regulation of the third party proxy voting regime, we submit that this matter is best regulated by the provincial securities authorities.

- *"empty voting" by shareholders without an economic interest in the corporation*

As noted above with respect to over voting, this issue requires further study to determine whether there are particular concerns that may appropriately be addressed in the CBCA.

**B. Shareholder and Board Communication**

The Committee recommended additional consultations on the following matters related to communication between shareholders and corporate boards under the CBCA:

- *electronic meetings for public companies*

We think there should always be a physical meeting room that shareholders can attend in person where senior management and the board are present.

- *facilitation of "notice and access" provisions under the CBCA*

The CBCA should facilitate such provisions. Provisions of the CBCA requiring corporations to mail paper copies of documents to all shareholders should be eliminated, perhaps in favour of an "opt-in" model whereby registered shareholders have the opportunity to annually elect to receive paper copies of documents by mail.

- *access to proxy circular by "significant" shareholders (more than 5-percent share ownership)*

We believe the current rules are prudent and supportable. A management circular and a dissident proxy circular are and should be treated as different documents. Corporations should not bear the cost of attempts of minority shareholders to advance their specific issues which may not be in the best interest of the corporation or supported by a majority of the shareholders. There are various CBCA provisions specifically designed to facilitate shareholder communication (including section 21(3) regarding access to the shareholder list and s 153 which requires intermediaries to send dissident proxy circulars to the beneficial owners). We submit these provisions represent a prudent, fair and reasonable compromise between the duties and mandate of boards and the protection of shareholder rights.

In addition, allowing 5% shareholders to access the company proxy process could, in our view, result in a communication chaos which would not serve <u>any stakeholder's</u> best interest (other than possibility the disgruntled shareholder).

- *equal treatment of shareholders in proxy process, irrespective of shareholder privacy concerns*

We submit that provincial securities laws currently governing the distribution of proxy materials to beneficial owners work well, and that it would be inappropriate to require companies to pay for the distribution of proxy materials to beneficial owners who object to their name and address being disclosed to the corporation (*i.e.*, "objecting beneficial owners" or "OBOs"). However, we would dispute the notion that these rules prevent OBOs from receiving information necessary to exercise their voting rights. Proxy materials and other disclosure documents are publicly available on SEDAR and by request from the corporation, and the proxy infrastructure has developed such that intermediaries are able to vote shares beneficially owned by OBOs. Moreover, the development of "notice and access" provisions under provincial securities laws (supported by appropriate corporate statutory amendments) will facilitate the provision of information to all shareholders, including OBOs.

- *shareholder proposal provisions, including*
    - *filing deadline*
    - *reasonable time to speak to a proposal at an annual meeting*

The filing deadline for shareholder proposals needs to be fixed. We have seen a number of instances where it is too difficult to determine the appropriate date. The deadline for filing proposals should be harmonized with the provincial approach of referencing the last annual meeting.

The CBCA should not specify the length of time a shareholder is to be given at a shareholders' meeting to explain and defend a proposal. This is a meeting issue that should be left to the Chair of the meeting. We think the Chair should be entitled to exercise judgment regarding what is appropriate in the circumstances.

## C. Board Accountability

*The Committee also recommended consultations on matters related to the accountability of boards of directors under the CBCA:*

- *roles of the Chief Executive Officer (CEO) and the Chair of the Board*

An effective corporate framework statute, in our view, should provide corporations with the flexibility to adopt officer and director roles that best serve the individual corporation's board and shareholder constituencies. A "one size fits all" approach to these matters is neither appropriate nor advisable.

We would also note that the issue is already appropriately covered in respect of public companies in applicable securities legislation, particularly National Instrument 58-101 and related forms, which requires Canadian public companies to disclose whether or not the chair of the board is an independent director. If the board has neither a chair that is independent nor a lead director that is independent, the issuer is required to describe what the board does to provide leadership for its independent directors. The ultimate goal should be effective corporate governance given the particular requirements of each issuer, which may or may not include having different individuals serve as chair and CEO.

- *shareholder approval of significantly dilutive acquisitions*

The use of the term "dilution" is typically confusingly used. We assume the Consultation is using it to mean that after a transaction or corporate action, the number of issued equity shares represent a smaller percent of a corporation's outstanding equity. We would suggest that is not a useful corporate concept. There is no reason to consider such a development is prima facie harmful or not in the best interests of a corporation. Conversely, it may represent a positive development for a corporation and its stakeholders.

In our experience, because most private corporations address this matter in shareholder documentation, we would suggest that this matter not be addressed in the legislation for private corporations because of a theoretical unfounded premise that it represents a problematic issue for shareholders.

All TSX listed companies now require shareholder approval if they propose to issue treasury shares that would result in dilution of more than 25%. We do not perceive any further regulation is required under the CBCA.

- *access to oppression remedy by shareholders*

We understand that the concern expressed was that requiring complainants to go to court to pursue the oppression remedy was too expensive and there should be alternative (i.e. cheaper) means. We assume this concern arises mostly with respect to public companies. For private companies, shareholders often enter into agreements with the corporation providing for alternative dispute resolution procedures, which often seek to avoid third party involvement and provide a method for shareholders and corporations to settle disputes among themselves or avoid disputes altogether (*e.g.*, through decision-making rules at the board or shareholder level or through the provision of exit mechanisms for shareholders who disagree with other shareholders regarding corporate policies or direction).

One suggestion for addressing oppression claims was arbitration. In our view, arbitration is not necessarily cheaper but it could be faster and confidential, both of which may assist the parties in reaching resolution. Perhaps giving the court the authority to order arbitration (and the terms thereof) or other alternative dispute mechanisms in appropriate circumstances would give some flexibility to the process.

It is worth recognizing that the oppression remedy is not found in many of the world's corporate statutes. Its existence in Canada reflects our historical links to English statutory and common law. The oppression remedy can be an unusually powerful method for shareholders to challenge decisions of a board of directors. However, in our view it is appropriate that such a powerful tool be used only with court oversight.

- *disclosure of the board's understanding of social and environmental matters on corporate operations*

In our view, this issue is applicable only to public companies, not private companies. Securities laws already require the corporation to disclose material facts relevant to its business. If the information is not material, we don't see any need to impose additional reporting requirements on corporations. If the corporation determines that it makes good business sense for whatever reason to disclose the information, it will do so. We submit that no changes are required to the CBCA on this issue.

## III. Securities Transfers and Other Corporate Governance Issues

*The Committee recommended consultations on the following issues:*

- *the potential removal of the CBCA provisions relating to securities transfers*

The securities transfer provisions should be updated to be consistent with the provincial securities transfer laws applicable to corporations. Each of the provinces and territories, other than PEI, has adopted securities transfer legislation based on the model legislation proposed by the CSA. CBCA companies should have one set of transfer rules apply to them, regardless of the province or territory in which they reside. The amendments should also include the ability of federal corporations to operate on a book entry only (no share certificate required) basis. The benefits of such an approach include: (i) reducing the costs associated with trading and settlement of securities; (ii) eliminating the risk of lost or accidentally destroyed share certificates; and (iii) reducing the cost of indemnities for the replacement of lost, damaged or stolen securities. The CBCA should respect modern practices which are efficient for shareholders.

- *insider-trading provisions in the CBCA*

In respect of public companies, given the scope of provincial legislation governing insider trading, we question the continuing usefulness of the insider trading provisions of the CBCA. With respect to private companies, insider trading rules are rarely relevant. However, to the extent it is determined to be useful to maintain the insider trading provisions of the CBCA for non-public companies, it should clarified that parties to a transaction may waive the application of such provisions by agreement. For example, in an M&A transaction, selling shareholders should be able, in the share purchase agreement, to exclude the application of the CBCA's insider trading rules to that transaction. If the parties are negotiating the terms of the transaction, the CBCA should not override the express agreement and give the purchaser additional rights to pursue the selling shareholders for failing to disclose information that the selling shareholders were not obliged to disclose under the share purchase agreement.

- *Canadian residency requirements for CBCA directors*

The Canadian residency requirement for directors should be eliminated. It is a remnant of a type of legal parochialism that should have no place in Canada today. Moreover, the requirement places CBCA companies at a competitive disadvantage to jurisdictions that do not impose a similar residency requirement, such as British Columbia, Nova Scotia, Yukon, New Brunswick and Québec. We regularly deal with businesses who choose not to incorporate under the CBCA for this very reason. There is no good reason to require any Canadian residents to serve on the board of Canadian corporations, especially when all the powers of the directors can be removed by a unanimous shareholder declaration (or unanimous shareholders agreement) and passed on to the shareholder(s).

- *regulation of trust indentures under the CBCA*

The CBCA should continue to govern trust indentures until there is some other uniform legislation in Canada.

- *the CBCA's modified proportionate liability regime*

The old regime under the CBCA was joint and several liability. We think the change to proportionate liability was a useful change. While this may not be consistent with the negligence legislation in certain provinces, the negligence legislation in certain provinces is also not consistent with other provincial legislation such as the provincial civil liability legislation under the securities statutes.

## IV. Incorporation Structure for Socially Responsible Enterprises

*The Committee recommended consultations regarding socially responsible enterprises:*

- *incorporation of hybrid enterprises (entities with both profit- making and non-profit goals) under the CBCA*

This seems like a useful addition to the range of legal entities available.

## V. Corporate Transparency

*The Government is seeking stakeholder views on the following:*

- *improved access to accurate and timely information, by competent authorities such as law enforcement and tax authorities, on beneficial ownership of corporations, including possibly through the establishment of a central repository of corporations incorporated under the CBCA;*

It is worth clarifying here whether the concern relates to the availability of information regarding beneficial owners of public companies, or of private companies.

With respect to public companies, we understand that many jurisdictions in the world have provided broader access to beneficial ownership information, such as the United Kingdom and Australia, and it would be useful to consider adopting similar procedures in Canada. Indeed, the CSA are considering how to improve the communication infrastructure between public companies and their beneficial owners: see the recent CSA Consultation Paper 54-401, "*Review of the Proxy Voting Infrastructure*" (August 15, 2013). A public company should be able to require nominees (such as CDS) to name the beneficial owner(s) so that it can know who its shareholders are. A key part of corporate governance is communicating with shareholders. If a corporation doesn't know who they are, it is very difficult to communicate with them. Relying on intermediaries to distribute information to shareholders means the company never really knows if its message is getting through and also makes it difficult for the company to meet face to face with shareholders (because it doesn't know who most of them are).

To the extent that the concern relates to the availability of information regarding owners of private companies, it is not clear to us that law enforcement and tax authorities currently lack the ability to obtain information regarding owners of corporations. CBCA corporations are already required to maintain a register of shareholders, which is available for inspection where warranted. Imposing additional obligations on corporations to provide ongoing access to law enforcement and other authorities regarding beneficial shareholder information would increase the costs of compliance for CBCA corporations. There may be benefits to law enforcement agencies and tax authorities from increased availability of information on beneficial ownership of corporations, but these potential benefits should be weighed against the increased costs of compliance.

- *disclosure of ownership information regarding bearer shares and bearer share warrants; and*

In our experience, bearer shares and bearer warrants are not commonly used securities. Most North American jurisdictions require shareholders to be listed on a register maintained by the corporation, and we do not find our clients have use for bearer securities in practice. We see little downside to eliminating provisions in the CBCA permitting the use of bearer securities. To the extent the ability to use bearer securities is maintained, it is hard to see how ownership information could be obtained. It is like keeping track of who holds Canadian currency.

- *disclosure by nominee shareholders of information on the individuals for whom they are acting.*

See our comments above re: disclosure of beneficial ownership.

## VI. Corporate Governance and Combating Bribery and Corruption

*Stakeholders and others are invited to provide input as to the adequacy of existing CBCA provisions on corporate records, accounting standards and audits to combat bribery in international transactions.*

We submit that the CBCA is not the proper legislation for provisions combating bribery and corruption. Directors have their duties under the CBCA. We think those are sufficient for that Act. There is other legislation dealing with foreign corrupt practices, such as the *Foreign Public Officials Act* and in our view that is proper legislation for any additional measures if the government thinks the current measures are not sufficient.

## VII. Diversity of Corporate Boards and Management

*Stakeholders and others are invited to comment as to whether new measures to promote diversity within corporate boards should be included in the CBCA and what such measures might entail.*

We submit that diversity on boards is an important issue for directors and shareholders to carefully consider and address. However, we do not think that this matter should be prescriptively dealt with in the CBCA. As is noted in the Consultation, the CBCA is a framework statute and does not prescribe how a corporation is to be run. The vast majority of corporations incorporated under the CBCA are privately-held. We think that private companies should be able to structure their corporate governance in whatever manner the shareholders determine.

Public companies require the flexibility to engage the best people available for their specific purposes. The CSA are currently reviewing the issue with respect to public companies and we think that is a more appropriate forum than the CBCA.

## VIII. Arrangements Under the CBCA

*Comments are invited as to whether the use of arrangements under the CBCA to restructure insolvent corporations is appropriate under certain circumstances and, if so, whether additional CBCA provisions may be necessary to safeguard the interests of creditors and other stakeholders similar to those found in insolvency statutes*

We submit that the use of arrangements under the CBCA to restructure insolvent corporations is appropriate for largely consensual balance sheet restructurings, which is the current practice. However, we do not think it would be appropriate to allow the CBCA arrangement provisions to be used by insolvent corporations in a manner that expands their availability beyond the current practice (i.e. restructurings that are not largely consensual balance sheet restructurings). The CBCA arrangement provisions were never intended or designed for those purposes and would accordingly require very extensive amendment (largely to replicate significant portions of the *Companies' Creditors Arrangement Act* (the "**CCAA**")[3] if the CBCA arrangement provisions were to be able to be used to restructure in those instances.

Given our view that the CBCA should only be used to restructure insolvent corporations in limited circumstances, with one exception described below, we do not think it is imperative to add additional provisions to the CBCA at this time. The CBCA arrangement provisions require court approval, which will only be granted where the arrangement is put forth in good faith, and is fair and reasonable in accordance with the legal principles outlined in BCE.[4] In addition, limiting the availability of CBCA restructurings in the insolvency context to largely consensual restructurings promotes the fair treatment of creditors and other stakeholders.

The one amendment to the CBCA arrangement provisions that we think should be considered is whether it is desirable to clarify that bank debt is a "security" (as defined in section 2(1) of the CBCA) and can therefore be compromised under the CBCA. The CBCA arrangement

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[3] R.S.C. 1985, c. C-36.
[4] *Ibid*

provisions are not intended to be used to compromise all types of debt (eg. trade debt) but we think the issue of whether it can be used to compromise all types of *funded* debt should be examined. In the recent Yellow Media CBCA restructuring, certain parties took the position in the litigation that funded debt provided by banks was not able to be compromised under the CBCA without their consent. But because the issue was ultimately settled by the parties out of court, uncertainty remains.

## IX. Corporate Social Responsibility

*Stakeholders and others are invited to submit comments as to whether the existing provisions of the CBCA adequately promote CSR objectives and whether additional measures to promote CSR objectives are warranted in the CBCA.*

We do not think the CBCA is the proper forum for this topic. The CBCA, as is noted in the Consultation, is a framework statute and does not prescribe how a corporation is to be run. We do think the CBCA, as interpreted by the Supreme Court of Canada in the *Peoples*[5] and *BCE*[6] decisions, makes it clear that the directors' duties are to the corporation, which includes the right to the board to consider all stakeholders, including environmental concerns and the local communities in which the corporation operates. We think this gives the board of a corporation ample room to make decisions for CSR reasons. If any changes were to be made to the CBCA in this regard, we would limit them to (a) expressly including the principle identified in BCE and (b) expressly including the business judgment rule. See our comments in Section 10 of Appendix B. As well, the CSA have made it clear to public companies that they must disclose environmental risks to the extent that they are material to the public company.

## X. Administrative and Technical Matters

*A. Should property of dissolved corporations that has vested in the Crown under the CBCA automatically be returned to revived CBCA corporations?*

Yes. Otherwise it undermines the purpose of the revival.

*B. Should there be a time limit on the money held by the Receiver General for unknown claimants of dissolved corporations?*

No.

*C. Should there be a time limit on the revival of a corporation that has been dissolved? Further, before returning property to a revived corporation, should the Crown be able to recover money spent on that property?*

1. Yes. 21 years.

2. Yes.

[5] *Peoples Department Stores Inc.* v. *Wise*, 2004 SCC 68.
[6] *BCE Inc.* v. *1976 Debentureholders*, [2008] 3 S.C.R. 560 ("BCE").

*D. Should there be a time limit on how long shareholders must hold shares before they can exercise the right of dissent?*

We submit that a shareholder should not be able to dissent in respect of a matter that was publicly disclosed prior to the shareholder becoming a shareholder. The right of dissent was not intended to permit shareholder arbitrage or opportunistic greenmail.

*E. Should the definition of "squeeze-out transaction" in section 2 of the CBCA be amended to remove the reference to amendment of articles?*

Yes.

*F. Should the CBCA be amended to make it clear that a consolidation of shares, with or without a repurchase of fractional shares, is not a transaction that triggers a right of dissent? Further, should "going- private transactions" permit the use of the right of dissent?*

1. We submit that consistency with Ontario and Quebec law on the consolidation point is desirable and would support prohibiting dissent in circumstances where the fractional interests created are nominal.

2. We submit that each corporation should be able to decide whether dissent rights will apply to particular types of transactions. It is customary for shareholders of private companies to agree not to exercise dissent rights in connection with specific types of transactions. Any amendments to the dissent provisions made by a corporation would be required to be added to the articles of the corporation. Any action taken by a corporation to amend its articles to reduce the scope of the dissent provisions would itself give rise to a dissent right.

*G. Should the CBCA more fully recognize beneficial owners of shares by giving them more of the rights of registered shareholders (e.g. the right to vote, the right of dissent)?*

No. It is unreasonable to expect a corporation to have direct contact with each of its beneficial shareholders, which would be necessary to grant expanded rights. This proposal is directly relevant to the beneficial owners of public companies. The interaction between public companies and their shareholders is best governed applicable provincial securities laws, including National Instrument 54-101 – *Communication with Beneficial Owners of Securities of a Reporting Issuer*. Further, the structure of Canadian stock markets, including the steps required to "clear" trades, necessitates that certain rights, including voting and dissent rights, should be limited to registered holders.

*H. Should the requirement for non-distributing corporations to solicit proxies have a higher shareholder threshold or be removed altogether?*

The requirement to solicit proxies currently applies to all corporations except those that have less than 50 shareholders <u>entitled to vote at a meeting (s. 149(2))</u>. If it applies, the corporation must also prepare and send to its shareholders a circular in the prescribed form (s. 150). We think the requirement for a circular should only apply to "distributing corporations" as is the case under the OBCA. If that change is not made, then we think the 50 shareholder number should be significantly increased (*e.g.*, to at least 150) because many private companies these days have a large number of small shareholders. They end up with a large number of small shareholders because of the way fund raising and compensation by stock option, particularly by technology companies, are currently done. Shareholders negotiate the type of information they want to receive in the shareholders agreement that governs these companies. At the very least, the solicitation requirement should be subject to any agreement to the contrary in a unanimous shareholders agreement.

If the exception is to be maintained in some form, we submit that the wording should be revised to provide that the applicable measurement is the number of voting shareholders entitled to vote at the meeting that is being called. For example using the current wording of the CBCA, if there is only one shareholder who holds voting shares and 100 who hold non-voting shares and a meeting is called to vote on a matter at which the non-voting shareholders are entitled to vote (e.g. sale of all the assets), then a circular should be required for that meeting. However a circular would not be required for a regular annual general meeting because there is only one shareholder who votes at that meeting.

*I. Should the threshold exception in the CBCA be raised so that a person is permitted to solicit proxies, other than by or on behalf of the management of the corporation, without sending a dissident's proxy circular if the total number of shareholders whose proxies are solicited is more than fifteen?*

*(No response)*

## APPENDIX B

Other Issues

### 1. Creation of Unlimited Liability Companies and Limited Liability Companies

Limited Liability Companies

A Limited Liability Company ("**LLC**") is a legal entity formed under state law in the United States, which combines the limited liability features of a corporation with the contractual flexibility of a partnership. We think that the CBCA should include provisions enabling the formation of LLCs (based on the principles similar to those which are enshrined in the Delaware statute) in order to: (i) make a strong statement to the international capital community that Canada is ready to make the investment process more transparent and flexible; (ii) reduce the transaction and legal costs of completing complex investments; (iii) simplify the process of bringing capital into Canada; and (iv) promote Canada as a place in which to carry on business within North America. The form of LLC would need to qualify as a flow through entity for US tax purposes and should not require resident Canadian directors. The great advance of the LLC is to permit shareholders to organize the company exclusively through the provisions of the LLC agreement, without the limitations imposed by corporate law. In many ways the LLC is a perfection of the concept, first articulated under corporate law, that shareholders should be free to arrange their affairs entirely among themselves without interference from the legislature. As capital markets become more complicated and more global, it is increasingly important that we afford this freedom to participants in Canada's capital markets.

Unlimited Liability Companies

The provinces of Alberta, British Columbia and Nova Scotia allow for the creation of Unlimited Liability Companies ("**ULC**") under their respective statutes. A ULC is a hybrid entity as it is treated as a corporation for Canadian tax purposes and can be treated as a flow-through or disregarded entity for U.S. tax purposes. An ULC is often an attractive vehicle for U.S. investors expanding into Canada. Accordingly, the ULC should also be part of the federal corporate laws of Canada. There is generally less interest in ULCs in the US since the latest amendment to the Canada-US tax treaty has made them more difficult to use. The form of ULC would need to qualify as a flow through entity for US tax purposes and should not require resident Canadian directors.

### 2. Removing unanimity for dispensing with annual audit requirement

Pursuant to Section 163 of the CBCA, the unanimous consent of all shareholders is required, annually, for a non-distributing corporation to dispense with an audit, regardless of a shareholder's status as a voting or non-voting shareholder or the size of such shareholder's investment. Such audits are often unnecessary, prohibitively expensive and disproportionate to the financial resources of the corporation. The universal application of this requirement may have unintended and severe consequences, particularly on small, privately-held corporations. For example, a single, minority, non-voting shareholder of a corporation may either insist upon an audit, or use its consent as leverage to compel the corporation to comply with its demands. In either instance, it may be unfair to the remaining shareholders to endure the consequences of such actions. Given the need to balance the foregoing concerns with the fact that all shareholders have a right to be informed, we suggest that the CBCA be amended to include statutory exemptions from audit requirements which are based on a minimum percentage of share ownership, or a corporation's revenues, assets or number of employees, similar to measures which have recently been adopted in Australia and the United Kingdom. We also submit that the shareholders should be able to perpetually waive the audit requirement pursuant to the articles or a unanimous shareholders agreement, rather than having to waive it on an annual basis.

### 3. Shareholder Consent resolutions – Delaware approach – Don't need all shareholders to sign

We suggest a provision similar to section 228 of the *Delaware General Corporation Law* be added to the CBCA because it is often not possible to locate all shareholders to obtain their signatures on a written resolution (as required by section 142(1)) and it imposes a higher standard on written resolutions (100% approval) than the voting threshold required at a meeting.

From s.228 of *Delaware General Corporation Law*": "Unless otherwise provided in the certificate of incorporation, any action required by this chapter to be taken at any annual or special meeting of stockholders of a corporation, or any action which may be taken at any annual or special meeting of such stockholders, may be taken without a meeting, without prior notice and without a vote, if a consent or consents in writing, setting forth the action so taken, shall be signed by the holders of outstanding stock having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares entitled to vote thereon were present and voted and shall be delivered to the corporation by delivery to its registered office in this State, its principal place of business or an officer or agent of the corporation having custody of the book in which proceedings of meetings of stockholders are recorded. Delivery made to a corporation's registered office shall be by hand or by certified or registered mail, return receipt requested."

### 4. Written Directors Resolutions in Lieu of Meeting

We think the CBCA should make it clear that a written resolution of the directors needs to be signed by all the directors but only needs to be approved by a majority of the directors signing it. In other words, directors who oppose a resolution may sign it indicating their opposition.

### 5. GAAP

Section 71 of the regulations to the CBCA requires CBCA corporations (other than SEC Registrants as defined) to use Cdn GAAP for their annual financial statements. CBCA corporations should be able to use whatever accounting principles best suit their needs.

### 6. Strict Liability of Directors Should be Eliminated

The recent outcome in the Ontario environmental case known as "Northstar" demonstrates that strict liability offences for directors are not appropriate as they will greatly reduce the pool of qualified individuals willing to serve as directors. In the Northstar case, the Ontario Ministry of the Environment pursued directors of a corporation for environmental contamination that occurred on the site the corporation occupied. The directors were not directors of the corporation when the contamination occurred and there was some dispute as to whether the contamination was caused by the corporation at all. The Ministry's position was that the directors had care and control of the corporation and they did not set funds aside for the clean up when the corporation filed for protection under the CCAA. The directors argued that the CCAA did not permit them to prefer environmental remediation ahead of other creditors and they were not responsible for causing the contamination in any event. In the end the directors paid about $5 million personally to settle the claims by the Ministry.

We suggest that the CBCA be amended to provide that strict liability offences will not apply to directors of CBCA corporations who have otherwise complied with their fiduciary duties and have a due diligence defence.

Our position on this is consistent with the Institute of Corporate Directors as disclosed in a story in *The Globe & Mail* on Oct 13/13 from which the following excerpt is taken:

> Stan Magidson, chief executive officer of the Institute of Corporate Directors, which represents 7,500 corporate directors in Canada, said the ICD has submitted a third-party witness statement in the Northstar appeal, the first time the organization has intervened in a legal matter.
>
> The ICD argues that Ontario's Environmental Protection Act allows directors to be held liable for pollution when they are negligent in preventing the contamination.
>
> But Mr. Magidson said directors should not be held liable for pollution they "did not cause and could not prevent" and when they were diligent in their duties.
>
> "We hope this case will make it clear directors will not be held liable if they acted responsibly," Mr. Magidson said in an interview. "If it were otherwise, this would have a chilling effect on directors joining boards of companies that have operations in Ontario that impact the environment, and this will be detrimental to Ontario's economy."

## 7. Court Approval Requirement for Director Indemnification Should be Modified

In its decision in <u>*Cytrynbaum v. Look Communications Inc*</u>. released July 4, 2013, the Ontario Court of Appeal affirmed a lower court ruling that "advancement" by the corporation to Look's former directors, for advance funding of the directors' legal costs to defend against an action brought by the corporation, is subject to Court approval. The former directors had been sued by Look (at the behest of successor directors), and had sought advancement of consequent expenses under their indemnity agreements with Look. Look declined to advance the expenses, and the former directors sued for an order compelling payment. On the facts as found, the trial Court refused to order advancement, and the Court of Appeal upheld that decision.

The former directors claimed that their indemnification agreements with Look entitled them to advance funding of their defence costs without any need for Court approval. The Court determined that the indemnity agreements could not override the express terms of the CBCA, that the Court construed as requiring prior Court approval. Although section 124(4) of the CBCA was headed by a marginal note saying "Indemnification in derivative actions", and the action by Look against the former directors was not derivative, but rather a direct action, the Court held that the marginal note was not determinative. In refusing to follow a similar Ontario case that had restricted the section to derivative actions, the Court concluded that the wording of the section was clear because it applied to actions "by" the corporation and not solely those "brought on behalf of" the corporation. The Court also declined to follow Delaware law because Delaware does not require Court approval of payments of this sort, as both the CBCA and OBCA do.

The Court reaffirmed the principle that directors are entitled to a presumption of good faith, but said that this presumption can be overcome where the corporation can demonstrate a strong *prima facie* case of bad faith. The Court said, "It is a stringent test that gives significant weight to the protection of directors. It ensures that they will ordinarily receive advance funding but leaves open the possibility that advancement will be denied when there is strong evidence of bad faith."

The Court concluded that Look had demonstrated a strong *prima facie* case of bad faith by the former directors.

The current rule prohibits payments unless and until the court approves them. We think that the rule should be revised to provide that the corporation must indemnify its directors in accordance with its bylaws and indemnification agreements in respect of an action by the corporation unless the corporation can demonstrate to the court a strong *prima facie* case of bad faith, in which case any bad faith payments previously made must be repaid. The corporation will also be required to pay all parties' costs of court application too, unless it wins. As a result, the payments would be permissible until the court says that they are not permissible.

The current approach is fine for derivative actions unless they are being brought on a derivative basis after the board has been replaced and could have been brought by the corporation just as easily.

## 8. **Unanimous Shareholders Agreement to Prevail**

Parties to a unanimous shareholders agreement should be able to amend or eliminate the application of the dissent and oppression sections of the CBCA as between the parties. We do not see any reason to preclude parties from contracting out of those obligations as between themselves by mutual agreement.

## 9. Duties of Directors

We think the principles of directors duties enunciated in BCE[7] and the Supreme Court of Canada decisions should be incorporated in the CBCA so that the law is clear. We suggest language along the following lines:

> 122. (1) Every director and officer of a corporation in exercising their powers and discharging their duties shall
>
> (a) act honestly and in good faith with a view to the best interests of the corporation; and
>
> (b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.
>
> (2) In determining whether a director is acting with a view to the best interests of the corporation, the director shall be entitled to, but need not, consider the interests of shareholders, employees, suppliers, creditors, consumers, governments, the environment and others who are stakeholders in or of the corporation, including the communities in which the corporation does business, whether such interests are short-term or longer-term, as well as all other pertinent information and the director shall be entitled to, but need not, be guided in the decisions and actions of the director by such considerations and by the intention that the corporation act as a good corporate citizen.

We also think the "business judgment rule" developed by the Canadian courts should become part of the CBCA. We suggest language to the following effect:

> (3) A director or officer who makes a business judgment in good faith fulfills the duty under this Section if the director or officer:
>
> (a) is not interested in the subject of the business judgment;
>
> (b) is informed with respect to the subject of the business judgment to the extent the director or officer reasonably believes to be appropriate under the circumstances; and
>
> (c) reasonably believes that the business judgment is in the best interests of the corporation.
>
> (4) A person challenging the conduct of a director or officer under this Section has the burden of proving a breach of duty, including the inapplicability of the provisions as to the fulfillment of duty under section 122(1) and (3), and, in a damage

[7] *BCE Inc. v. 1976 Debentureholders* [2008] 3 S.C.R. 560.

action, the burden of proving that the breach was the cause of damage suffered by the corporation.

## 10. Meaning of "if exercised"

A technical issue is the meaning of "if exercised" in the Control definition (section 1(3)(b)) particularly in the context of private companies with a unanimous shareholder agreement. This definition, for many years, has given rise to confusion and inconsistent legal advice to its interpretation or its intended purpose. To our knowledge, there is no authoritative jurisprudence on this matter.

## 11. Collateral Payments to Directors

In our view, the nascent practice in the United States in which shareholders who nominate certain directors pay those directors collateral compensation in addition to their compensation from the corporation of which they are a director erodes the foundation of the directors' duty of loyalty. It creates a potential conflict of interest which at least in perception undermines the confidence of shareholders that directors' conduct be conflict free. We would suggest the CBCA allow the adoption, in the articles or by laws of a corporation, of an absolute prohibition of the practice.