



Institute for governance
of private and public organizations

Consultation on the *Canada Business Corporations Act*

**Professor Yvan Allaire, Ph.D. (MIT), FRSC
Executive Chair
Institute for Governance (IGOPP)**

May 14, 2014

Submission of IGOPP to Industry Canada in reply to request for comments during the public consultations on the *Canada Business Corporations Act*.

Professor Yvan Allaire, Ph.D. (MIT), FRSC
Executive Chair
Institute for Governance (IGOPP)

yallaire@igopp.org

May 14, 2014

VIA EMAIL

Attention:

Director General
Marketplace Framework Policy Branch
Industry Canada
235 Queen Street, 10th Floor
Ottawa, Ontario
K1A 0H5
Email: cbca-consultations-lcsa@ic.gc.ca

ABOUT IGOPP

THE REFERENCE IN GOVERNANCE MATTERS

Created in 2005 by two academic institutions (HEC Montréal and Concordia University – The John Molson School of Business) and the Stephen Jarislowsky Foundation, the Institute for governance (IGOPP) has become a centre for excellence about governance of public and private organizations. Through research, training programs, policy papers and participation in public debates, IGOPP has become a key reference on all issues of governance in the private and public sectors.

OUR MISSION

- Strengthen fiduciary governance in the public and private sectors;
- Make organizations evolve from a fiduciary mode of governance to a *value-creating governance*[®];
- Contribute to debates, and the solution, of governance problems by taking positions on important issues and by a wide dissemination of information and knowledge about governance.

OUR ACTIVITIES

The Institute's activities focus on the four following areas:

- Policy papers
- Training
- Research
- Knowledge dissemination

COMMENTS ON THE QUESTIONS RAISED IN THE CONSULTATION PAPER

Our Institute has taken formal positions on five particular issues identified for review and consultation. We will examine these issues individually to formulate specific recommendations in each case.

The topics covered are the following:

1. Shareholder advisory votes on compensation packages (p.5)
2. Diversity of board membership (p.6)
3. Equal treatment of shareholders (p.8)
4. Parties who can claim oppression (p.9)
5. Adding a minimum holding period for the right to nominate directors (p.10)

1. Shareholder advisory votes on compensation packages

*Giving Shareholders a Say-on-Pay: A measure leading to better governance?*¹

The debate surrounding Say-on-Pay bears on the purpose and consequences of such a measure as well as on the advisability of extending this requirement to all publicly listed companies, even though most companies have raised little concern about their compensation policies. Undoubtedly, the call for a non-binding, shareholder vote on executive compensation signals a clear mistrust for boards of directors. This measure signals a small but significant shift in responsibility for corporate governance away from boards of directors towards shareholders.

This proposed measure represents a vote of no confidence for boards of directors. If that lack of trust and confidence extends beyond the financial sector (where recent events have clearly damaged this trust and confidence), it would imply a wholesale revamping of corporate governance. What other decisions once the exclusive purview of corporate boards should be submitted to a shareholder vote (non-binding at first, binding eventually). If corporate boards cannot be trusted to make the right decision on executive compensation, how can shareholders rely on their judgment for other equally important decisions, such as selection of CEO, acquisitions, capital allocation?

A consultative vote by shareholders on executive compensation deviates from the logic and legal standing of boards fully responsible and accountable for the governance of corporations. It opens the doors to a creeping encroachment by shareholders who would intervene directly on matters previously regarded as the board's exclusive responsibility.

Thus, the Institute is **not favorable to a general requirement that companies hold a non-binding vote by shareholders on their compensation policies and practices**. The practice of a dialogue between large shareholders and board of directors should be continued and expanded. If

¹ For an exhaustive discussion on the topic, we invite the reader to consult our Position Paper No.5, *Giving Shareholders A Say on Pay: A Measure Leading to Better Governance* (March 2010), in the document attached hereto as Schedule A.

shareholders are dissatisfied with the policies and the level of executive compensation in a particular company, they should either:

- a) Propose to shareholders the adoption of a say-on-pay;
- b) Vote on compensation, or vote against the election of specific board members;

That step is more likely to bring about improved governance practices.

2. Diversity of Board Membership

The place of women on board

Even for a patient observer, it is clear that the rate of change in the participation of women on corporate boards is glacially slow. Once upon a time, there were plausible reasons that explained the weak representation of women on boards of directors. The historical lag in the rate of women graduating with degrees in management played a role. The established networks from which emerged candidates for board membership were also influencing the ratio of women on boards.

Once the fact is accepted as incontrovertible that women are equal to men in intelligence, competence, integrity and independence of mind, the issue then becomes how to raise in a sensible manner their representation on boards of directors. That is a matter of principle, equity and fairness.

Advocates for increased participation of women on boards of directors should be careful about basing their argument on the supposed economic benefits of increased female participation. Studies purporting to demonstrate such benefits are always controversial, subject to methodological criticisms. The economic performance of companies results from so many factors, interrelated and time-dependent, that to isolate the influence of a single variable such as the ratio of women on the board requires a suspension of disbelief. And if a study, as well (or poorly) done as the others, were to conclude that there is a negative correlation between performance and the number of women on boards, should the drive to better representation of

women stall or stop?

The most troubling aspect of this issue is that a fundamental variable is never brought into the discussion: *the turnover rate of board membership*. The Spencer Stuart report for 2010 shows that there were some 87 new members out of 1150 members on boards of the 100 largest corporations, or a rate slightly above 7%.

With a turnover rate of 7%, board membership changes entirely over a 10- year period; with a turnover rate of 10% the board changes one and a half time in 10 years; with a turnover of 15%, the board would change completely over a five-year period and rolls over three times over a ten-year period..

Will board turnover rate increase in years to come or can it be pushed up?

There may be some acceleration of turnover as board members age and policies continue to be adopted over the next few years to put limits on the age and the number of years of service of board members. Of course, boards have to do a better job of evaluating their members and push out those who do not perform up to a high standard, which could raise the turnover rate for a period of time. But it is doubtful that a rate much higher than 7% may be sustained over a long period *and it may not be wise governance to experience too high a rate of board turnover*.

Boards of directors must make some vigorous and public commitments to raising the participation of women to their boards. They should set a policy to achieve a reasonable turnover of their board membership and adopt a policy of ***appointing one woman for every two board vacancies until women represent 40% of their board members***.

That may not meet the calendar and deadline of some activists on the subject but it is a fair and balanced way to generate benefits for all parties, most particularly for women.

3. Equal treatment of shareholders

Rewarding “loyal” shareholders

The mixture of shareholders and “share swappers” as well as the trading “innovations” concocted by some hedge funds (more aptly called speculative funds) are a troubling phenomenon. In a context where new financial players intend to change the rules of the game to their advantage, long-term investors must also be concerned with the behavior of the fellow shareholders. Driven by different motives and esoteric strategies, these new types of “shareholders” may have interests and goals that are detrimental to the long-term welfare of the company and its stable shareholders.

Confronted by these changed market circumstances, rather than further increase the power of transient, fickle, even malevolent, “shareholders”, should we not propose measures that favour long-term shareholding and instil loyalty and commitment to the long-run goals of the corporation? *In decent societies, tourists don’t vote and gamblers don’t own the casino!*

In different policy papers, IGOPP has proposed that companies should consider stability inducing measures for its shareholders, such as:

- A minimum holding period (say one year) before shares acquire voting rights;
- Offering a “loyalty dividend” or a doubling of voting power for each share held for, say, two years or more.

However, such latitude granted to corporations would require a modification of the article stating that all holders of the same class of shares must be treated equally (CBCA, s. 24(3); s. 176(1)), quoted hereunder:

24. (3) *where a corporation has only one class of shares, the rights of the holders thereof are equal in all respects and include the rights*

(a) to vote at any meeting of shareholders of the corporation;

(b) to receive any dividend declared by the corporation; and

(c) to receive the remaining property of the corporation on dissolution.

We propose that this clause be modified to include “**unless unequal treatment is associated solely to the holding period of said shares**”.

4. Parties who can claim oppression

The Supreme Court of Canada has made the point forcefully in the course of two recent judgments [Peoples v. Wise (2004) and BCE/Bell Canada v. Bond-holders (2008)] that the fiduciary duties of directors, under the Canadian Business Corporations Act (as well as under its Quebec counterpart, adopted in December 2009) *is to act in the interests of the corporation, and not exclusively in the interests of shareholders.*

The Court states that, “[i]n considering what is in the best interests of the corporation, directors may look to the interests of, *inter alia*, **shareholders, employees, creditors, consumers, governments and the environment** to inform their decisions.”

We believe that the list of stakeholders under Section 214 (and 241), which states:

- 214.** (1) *A court may order the liquidation and dissolution of a corporation or any of its affiliated corporations on the application of a shareholder,*
- (a) *if the court is satisfied that in respect of a corporation or any of its affiliates*
 - (i) *any act or omission of the corporation or any of its affiliates effects a result,*
 - (ii) *the business or affairs of the corporation or any of its affiliates are or have been carried on or conducted in a manner, or*
 - (iii) *the powers of the directors of the corporation or any of its affiliates are or have been exercised in a manner*

*that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any **security holder, creditor, director or officer**; or*

- (b) *if the court is satisfied that*
 - (i) *a unanimous shareholder agreement entitles a complaining shareholder to demand dissolution of the corporation after the occurrence of a specified event and that event has occurred, or*
 - (ii) *it is just and equitable that the corporation should be liquidated and dissolved.*
- (2) *On an application under this section, a court may make such order under this section or section 241 as it thinks fit.*

We suggest that this list should be expanded to include, as per the decisions of the Supreme Court, at least **employees**. Other parties have claims under different laws and regulations.

5. Adding a minimum holding period for the right to nominate directors

The CBCA (S.137 (4)) presently states that:

“a proposal may include nominations for the election of directors if the proposal is signed by one or more holders of shares representing in the aggregate not less than five per cent of the shares or five per cent of the shares of a class of shares of the corporation entitled to vote at the meeting to which the proposal is to be presented, but this subsection does not preclude nominations made at a meeting of shareholders”.

In 2010, the Securities and Exchange Commission (SEC) made a proposal to facilitate the rights of shareholders to nominate directors to a company's board (our emphasis added):

Shareholders will be eligible to have their nominee included in the proxy materials if:

- *They own at least 3 percent of the total voting power of the company's securities that are entitled to be voted on the election of directors at the annual meeting. Shareholders will be able to aggregate holdings to meet this threshold.*
- *Shareholders **will be required to have held their shares for at least three years** and will be required to continue to own at least the required amount of securities through the date of the meeting at which directors are elected.*
- *Shareholders will not be eligible to use the rule if they are holding the securities for the purpose of changing control of the company, or to gain a number of seats on the board of directors that exceeds the number of nominees a company is required to include under new Rule 14a-11.*

The rule was vacated on technical grounds following a decision by the United States Court of Appeals, District of Columbia, in the case of *Business Roundtable v. SEC.*, but the arguments to include the holding requirements still stands in our view. The SEC justified the holding period requirement by their “belief that holding securities for at least a three-year period better

demonstrates a shareholder's long-term commitment and interest in the company"² and that this holding period is limiting the possibility of shareholders attempting to use the rule inappropriately, notably as a means to quickly gain control of a company.

Considering the long term interest of the corporation and its stakeholders, we propose that the right to nominate candidates for as directors should be available only to holders of 5% or more of the shares **who have held their shares for at least two years**. The minimum holding period should thus be expressly stated in S.137 (4).

² Securities and Exchange Commission. *Facilitating Shareholder Director Nominations*, Release Nos. 33-9136; 34-62764; IC-29384; File No. S7-10-09