

Industry Canada Consultation on the *Canada Business Corporations Act*

Comment

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I am currently working on a PhD concerning unanimous shareholder agreements, an aspect of the *Canada Business Corporations Act* that has itself been the subject of an Industry Canada discussion paper. The key section of the *C.B.C.A.* setting them out is s. 146. I believe that this tool for corporate governance may be relevant to several of the topics that are the subject of this consultation. I therefore wish to touch upon some of those connections, although I will not be providing in-depth commentary, so that they can be borne in mind as these issues are considered.

I. Executive Compensation

A unanimous shareholder agreement is one method for controlling executive compensation. (See *C.B.C.A.* s. 125.) It is obviously not usually the most convenient way to do so, given the criteria for its formation. That said, the terms of these documents are significantly entrenched, preventing the board of directors or a majority shareholder from altering them, which may be advantageous for this purpose. (There is some ambiguity about whether unanimous shareholder agreements can ever be amended or terminated non-unanimously under the *C.B.C.A.* without resort to the courts; I assume not.)

II. Shareholder Rights

A. Voting

Even if shareholders who exert power over a corporation via a unanimous shareholder agreement are subject to substantially the same duties of care and loyalty that normally bind directors, but especially if not (there is disagreement on whether they are), "empty voting" of the sort described could be a practical

problem in that context. If steps were being taken to combat the general problem of "empty voting" by shareholders, it would be useful to consider whether such efforts could be extended to the area of unanimous shareholder agreements as well.

B. Shareholder and Board Communication

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C. Board Accountability

Some of the rights described (including guaranteed speaking time at meetings, a requirement for shareholder approval of dilutive acquisitions, and mandatory disclosure by the board of environmental and social matters, as well as similar items) could be included in a unanimous shareholder agreement. This is again not often a convenient or feasible method of dealing with these issues, but under the correct circumstances, it might be used to achieve the stated goals (subject to some general uncertainties in the law about the valid uses and effects of unanimous shareholder agreements).

III. Securities Transfers and Other Corporate Governance Issues

It has been noted, including in the Industry Canada discussion paper on unanimous shareholder agreements, that they allow for the decision-making authority of the directors to be transferred to shareholders none of whom are resident Canadians.

IV. Incorporation Structure for Socially Responsible Enterprises

A unanimous shareholder agreement could potentially be a tool to transform a company into a socially responsible enterprise as defined. Although proper drafting of a document to achieve this effect might pose difficulties, restrictions upon the powers of directors in a unanimous shareholder agreement could arguably include ones that required them to take non-profit factors into account.

It might be worthwhile for the *C.B.C.A.* to explicitly state that this type of restriction upon the

directors is valid for inclusion in a unanimous shareholder agreement and/or provide additional rules governing such a scenario.

I agree with the comment referred to on p. 24 of the 2010 Committee report *Statutory Review of the Canada Business Corporations Act* that tax rules, not corporate law, might be an obstacle to favourable tax treatment of such arrangements.

VII. Diversity of Corporate Boards and Management

Much like residency requirements, the use of a unanimous shareholder agreement could potentially frustrate the practical effect of rules regarding diversity of corporate boards, by transferring authority to shareholders who would not be subject to the same requirements.

IX. Corporate Social Responsibility

A unanimous shareholder agreement could encourage corporate social responsibility, a possibility described above regarding socially responsible enterprises. It could also have the opposite effect, if shareholders were able to use these agreements to directly or indirectly assert control over the company in a manner that caused it to favour their interests at the expense of other considerations.

To the extent that the goal of corporate social responsibility is included in the *C.B.C.A.*, this factor should be accounted for, or it could frustrate the effects of reforms.

X. Administrative and Technical Matters

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)?

There is some uncertainty about whether "all the shareholders" who must agree to form a unanimous shareholder agreement (see *C.B.C.A.* s. 146 (1)) refers to the registered shareholders, the beneficial shareholders, or both. Clarifying this would be a positive development.

Oddly, where a corporation has only one beneficial owner of shares, the *C.B.C.A.* is clear that that person can create a document with the force of a unanimous shareholder agreement. (See *C.B.C.A.* s. 146 (2).) This is arguably broader than ideal, since the definition of "beneficial ownership" in s. 2 (1) apparently extends beyond situations where the registered shareholder is a financial intermediary as defined in s. 147 and includes "ownership through any trustee, legal representative, agent or mandatary, or other intermediary."

It is not clear why different approaches were used in these two subsections. It is possible to construct arrangements where both or neither would be applicable. The same standard should be adopted regardless of the number of shareholders, whichever it is.

If a registered shareholder is an "intermediary" as that term is defined in s. 147, then I suggest that the consent of the beneficial owners of those shares should be required to the creation and terms of a unanimous shareholder agreement, either directly or by providing written instructions to the intermediary to act on their behalf. In any other circumstance, it should only be the registered shareholder whose agreement is required, even if some other person has some beneficial interest in the shares in question.