CHAPTER 01

CBCA Reforms: Canadian Government Codifies Corporate Governance Practices

In 2019, the Canadian federal government enacted several important reforms to the *Canada Business Corporations Act* (CBCA) that reflect its increased focus on corporate governance best practices. In this chapter, we explore key areas in which the amendments will affect Canadian public companies, including requiring public companies to hold annual non-binding "say-on-pay" votes, and prescribing new disclosure requirements regarding diversity, the well-being of companies' employees, retirees and pensioners, and the clawback of director and executive compensation. We also discuss the codification of key elements of the Supreme Court of Canada's seminal 2008 decision in *BCE Inc. v 1976 Debentureholders* regarding directors' and officers' duties to act in the best interests of the corporation. Finally, we review the CBCA's enhanced investigative powers and expanded enforcement provisions, which necessitate attention by private corporations to the statute's share register requirements.

Overview of Key CBCA Amendments

Amendments to the CBCA announced on March 19, 2019 in the federal budget (Bill C-97) signal that the current federal government envisions a more robust role for itself as a proponent of corporate governance best practices in Canada.

The CBCA corporate governance–related amendments include the following:

- codifying key elements of the 2008 decision of the Supreme Court of Canada (SCC) in *BCE Inc. v 1976 Debentureholders* (*BCE*)[1] regarding directors' and officers' duties to act in the best interests of the corporation;
- requiring that certain public CBCA corporations disclose to shareholders their approach to remuneration and hold annual non-binding shareholder say-on-pay votes;
- new disclosure requirements applicable to certain CBCA corporations regarding diversity, the well-being of companies' employees, retirees and pensioners, and the clawback of director and officer compensation; and
- enhanced investigative powers and enforcement provisions regarding the requirement that private CBCA corporations maintain a register of individuals with significant control.

The following sections examine each of these amendments in turn.

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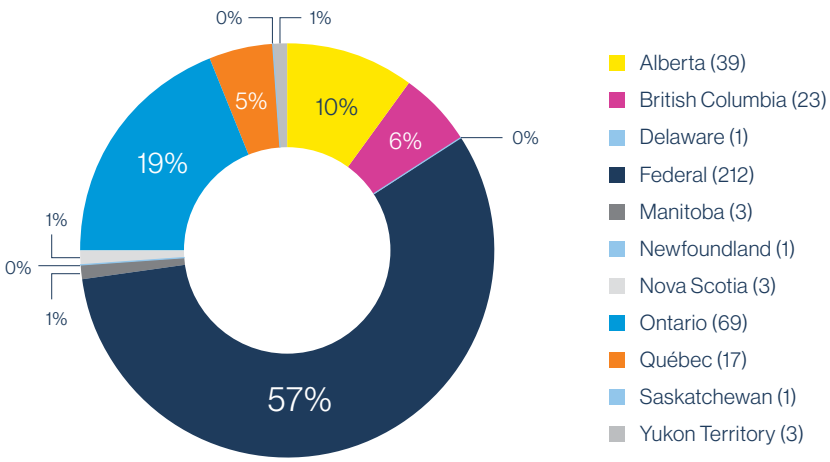
FIGURE 1-1:
Jurisdiction of Corporations on the TSX Composite and SmallCap Indices (Number and Percentage) (2019)



Codification of *BCE* Fiduciary Duties

The CBCA amendments, which came into force on June 21, 2019, codify key elements of the SCC's 2008 groundbreaking decision in *BCE* regarding directors' and officers' duties to act in the best interests of the corporation.

The CBCA (like provincial corporate statutes) imposes a duty on directors and officers to act honestly and in good faith with a view to the best interests of the corporation. As we discussed in detail in last year's *Davies Governance Insights 2018*,[2] the SCC in *BCE* considered this "fiduciary duty" in the context of a leveraged buyout transaction where the interests of shareholders conflicted with those of certain bondholders of Bell Canada. The Court reaffirmed its decision in *Peoples Department Stores (Trustee of) v Wise* that "although directors *must* consider the best interests of the corporation, it may also be appropriate, although *not mandatory*, to consider the impact of corporate decisions on shareholders or particular groups of stakeholders," including "the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment."[3]

This principle has now been codified in the CBCA, by providing that in satisfying their duty to act in the best interests of the corporation, directors and officers may, but are not required to, consider the following:

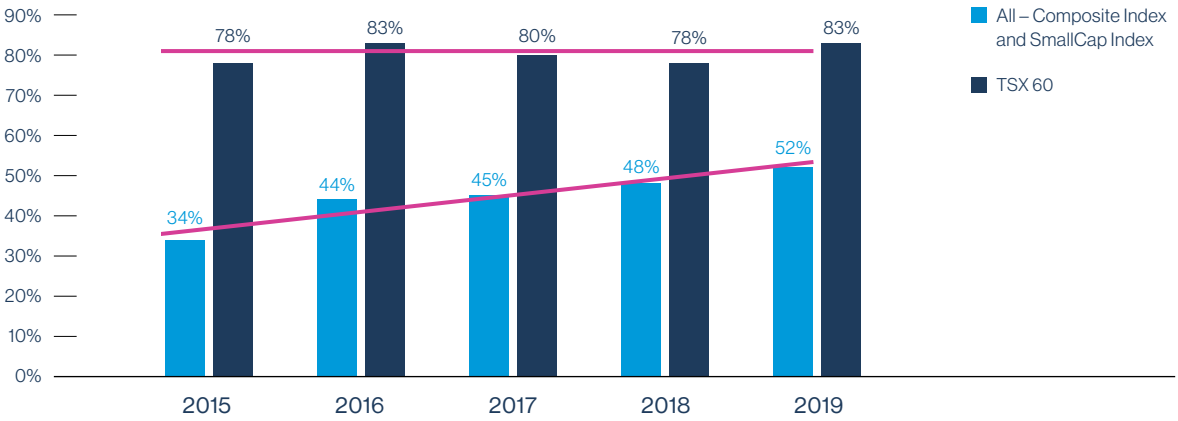
- the interests of shareholders, employees, retirees and pensioners, creditors, consumers and governments;
- the environment; and
- the long-term interests of the corporation.

The CBCA amendments codify key elements of the SCC's 2008 groundbreaking decision in *BCE* regarding directors' and officers' duties to act in the best interests of the corporation.

Notably, retirees and pensioners were not specifically named stakeholders in the *BCE* decision; however, the explicit reference to retirees and pensioners is consistent with the federal government's policy focus on the protection of workers and pensioners.

It is unclear why these amendments were considered necessary or whether their implementation will result in any change in the behaviour of boards of CBCA corporations, since the principles stated in *BCE* are well known and frequently applied by Canadian courts. However, these changes may be consistent with developments witnessed elsewhere – namely, that many institutional investors and some issuers are increasingly focusing on a broader scope of stakeholders, interests and time horizons in determining the best interests of the corporation. Further details are contained in Chapter 9, What's Next for Public Companies? Becoming a "Next Generation" Governance Organization.

FIGURE 1-2:
Percentage of Companies that Adopted Say-on-Pay (2015–2019)



Mandatory Compensation Disclosure and Say-on-Pay Vote

While many Canadian public companies have voluntarily adopted annual advisory say-on-pay votes on executive compensation, there is no legal requirement in Canada for a corporation to conduct such a vote, unlike in the United States and the United Kingdom. In 2019, 83% of companies on the TSX 60, and 52% of all Composite Index and SmallCap Index issuers held say-on-pay votes. Additional details about say-on-pay and related executive and director compensation trends and developments in Canada and the United States can be found in *Davies Governance Insights 2018*.[4]

The CBCA amendments will now require "prescribed corporations" to develop and annually disclose to shareholders their approach to the remuneration of "members of senior management," to put this approach to annual non-binding shareholder say-on-pay votes; and to publicly disclose the results of the votes. The scope of prescribed corporations and the members of senior management to which these amendments will apply will be set out in regulations that have yet to be published.

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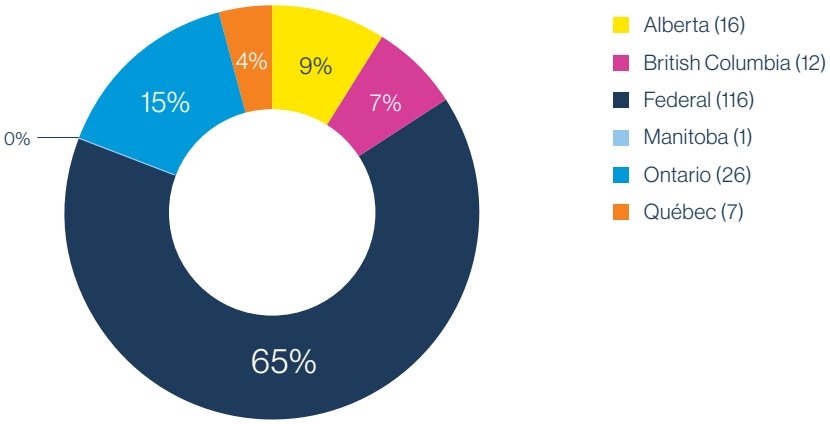
Spotlight: Recent Say-on-Pay Shareholder Proposals

Imperial Oil Ltd. (a CBCA corporation), Power Corporation of Canada (a CBCA corporation), Linamar Corporation (an Ontario corporation) and CGI Inc. (a Québec corporation) each faced a shareholder proposal asking the company to consider adopting a say-on-pay vote at its most recent 2019 annual shareholders' meeting. Unlike many other Canadian issuers that have voluntarily adopted the practice, the boards of directors of each of these four companies recommended that their shareholders vote against the proposals. They argued that the process of shareholder feedback on executive compensation could be better addressed through direct shareholder communications with the board and the corporation than through an allegedly blunt voting process, which was administratively burdensome and not issue-specific. Of note, the proposals were filed not only by various interest groups (SHARE and MÉDAC) that have been advocating for expanded say-on-pay votes in Canada and regularly submit proposals on different topics to public companies, but also by various Canadian institutional investors, including BC Investment Management Corporation, Seamark Asset Management Ltd., PSP Investments, the Alberta Investment Management Corporation and Caisse de dépôt et placement du Québec. When the regulations on say-on-pay are promulgated under the CBCA, regardless of the merits for not adopting say-on-pay, it is highly likely that Imperial Oil and Power Corporation, as CBCA companies, will need to adopt annual say-on-pay votes even though all proposals were defeated at their respective shareholders' meetings. Linamar and CGI, however, would not be required to adopt such votes, since they are, respectively, Ontario and Québec corporations.

FIGURE 1-3:
Composite Index and SmallCap Index Corporations by Jurisdiction that Did Not Adopt Say-on-Pay (Number and Percentage) (2019)



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Although Bill C-97 received royal assent on June 21, 2019, at the time of writing this report the say-on-pay amendments have not yet been brought into force. The federal government has indicated it will undertake public consultations – in which public companies are expected to be able to participate – on the proposed amendments before adopting more detailed regulations. It remains to be seen whether the federal government will expand the requirements beyond current market practices.

New Disclosure Requirements on Diversity, Well-Being and Clawback of Incentives

The CBCA amendments will require prescribed corporations to disclose to shareholders information regarding the following:

- diversity among the directors and "members of senior management" (as defined by regulation);
- the well-being of employees, retirees and pensioners; and
- the clawback of incentive benefits and other benefits paid to directors and "members of senior management."

The federal government has since published amendments to the *Canada Business Corporations Regulations, 2001*, regarding the diversity disclosure requirements that will come into force when the diversity-related amendments to the CBCA are brought into force on January 1, 2020, in advance of the 2020 proxy season. Under the amended regulations,[5] the diversity disclosure requirements will apply to all public companies incorporated under the CBCA, including companies on the TSX Venture Exchange (TSXV), which have not to date been subject to the corresponding diversity-related disclosure requirements under Canadian securities laws. "Members of senior management" of corporations to which the above requirements will apply are defined as (i) the chair and vice-chair of the board; (ii) the president; (iii) the chief executive officer and chief financial officer; (iv) the vice-president in charge of a principal business unit, division or function, including sales, finance or production; and (v) an individual who performs a policy-making function. This definition is consistent with the definition of "executive officers" to which the corresponding diversity disclosure under National Instrument 58-101 – *Disclosure of Corporate Governance Practices* (NI 58-101) applies.

The amended regulations prescribe the following diversity disclosure by a public corporation:[6]

- whether or not the corporation has adopted term limits for its directors or other mechanisms of board renewal and a description of those term limits or mechanisms, or the reasons why it has not adopted them;
- whether or not the corporation has adopted a written policy relating to the identification and nomination of members of "designated groups" for directors and, if not, the reasons why;
- if the corporation has adopted the written policy referred to above, (i) a short summary of its objectives and key provisions; (ii) a description of the measures taken to ensure the policy is effectively implemented; (iii) a description of the annual and cumulative progress by the corporation in achieving the policy's objectives; and (iv) whether or not the board or its nominating committee measures the effectiveness of the policy and, if so, a description of how;
- whether or not the board or its nominating committee considers the level of the representation of designated groups on the board when identifying and nominating candidates for election or re-election to the board and how that level is considered, or the reasons why it is not considered;

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- whether or not the corporation considers the level of representation of designated groups when appointing members of senior management and how that level is considered or the reasons why it is not considered;
- whether or not the corporation has, for each group within the designated groups, adopted a target number or percentage (or range) for group members to hold positions on the board or as members of senior management by a specific date and:
  - for each group for which a target has been adopted, the target and the annual and cumulative progress in achieving that target; and
  - for each group for which a target has not been adopted, the reasons why; and
- for each group within the designated groups, the number and proportion, expressed as a percentage, of members of each group who hold positions on the board and are members of senior management, including all of its "major subsidiaries."

Although the required CBCA disclosure above is nearly identical to corresponding requirements under NI 58-101, it is important to note that it applies to all designated groups, which goes beyond gender. "Designated groups" means women, Aboriginal peoples, persons with disabilities and members of visible minorities. And as noted above, these disclosure requirements will apply to all CBCA public companies, with the result that TSXV-listed companies will need to provide this disclosure annually to their shareholders. Lastly, these requirements also apply to all "major subsidiaries" of CBCA public companies, which may require additional work for many issuers, particularly those with more complex organizational structures.

The federal government's stated policy objective in introducing the diversity disclosure requirements is to promote diversity at both the board and senior management levels, because increased diversity is said to be not only a question of fairness but also a means to improved board quality, innovative thinking and corporate performance. Nonetheless, many have expressed concerns about the federal government wading into an area that is already covered under Canadian securities laws, while simultaneously expanding the scope of disclosure to more issuers and beyond gender. Among other articulated concerns, the CBCA amendments now create inconsistent disclosure requirements among TSXV issuers, since only those incorporated under the CBCA will be subject to any diversity-related

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disclosure requirements. In addition, inconsistent disclosure standards will now exist among TSX-listed issuers, since only CBCA-incorporated issuers will need to provide the expanded disclosure on designated groups, whereas under NI 58-101 others need only provide this disclosure with respect to women. Lastly, some have expressed concern that these requirements are, in fact, quite burdensome (and more so than the federal government articulated in its cost-benefit analysis conducted in connection with the CBCA amendments)[7] – for example, likely requiring issuers to set up self-identification and reporting systems to collect and compile the requested information in respect of different designated groups for the issuer and all major subsidiaries. It also remains to be seen whether these amendments will result in "forum shopping" by issuers, particularly junior issuers or new entrants to Canada's capital markets.

In addition to providing the above disclosure to shareholders annually, prescribed corporations must also file the information with Corporations Canada. We understand the federal government is working through the mechanics for facilitating these filings, including whether or not the filing of such information on SEDAR would satisfy the corporate filing.

With respect to the well-being and clawback disclosure, the federal government's policy focus appears to be on providing better oversight of corporate behaviour and the protection of employees, retirees and pensioners – a theme that was evident throughout the 2019 federal budget. These disclosure requirements will be brought into force by the federal government at a later date, not yet determined at the time of writing this report.

Share Register Requirements

The CBCA amendments also require that private CBCA corporations (including subsidiaries of publicly traded corporations) maintain a detailed share register of individuals with "significant control" over the corporation. The intent of these amendments is to provide greater transparency about the individuals who own and/or control corporations and to be consistent with international initiatives aimed at combating tax evasion, money laundering and terrorist financing. An individual with significant control is any individual who, *directly or indirectly*, holds registered or beneficial ownership of (i) shares that carry 25% or more of the voting rights attached to the corporation's shares, or (ii) 25% or more of the corporation's shares measured by fair market value.

The share register must contain specified information about each individual with significant control, including name, birth date, address, jurisdiction of residence for tax purposes, the date on which the individual became or ceased to be an individual with significant control and a description of how each individual is an individual with significant control (i.e., a description of the individual's interests and rights in respect of shares of the corporation). The share register must be updated within 15 days of the corporation becoming aware of any change to the information required to be included in the share register.

The register must be disclosed to the Director of Corporations Canada on request and must be made available for inspection by shareholders and creditors of the corporation. Additional CBCA amendments that came into force on June 21, 2019, create enforcement powers for the share register requirements. Corporations will be required to disclose their significant shareholder registers to investigative bodies (including police forces and the Canada Revenue Agency) when the investigative body has reasonable grounds to suspect that the share register would be relevant in investigating an offence committed by or involving the corporation or an individual with significant control. Any director or officer who knowingly authorizes, permits or acquiesces in the contravention of the new shareholder register requirements may be liable to a fine of up to $200,000, six months' imprisonment, or both, whether or not the corporation is prosecuted for a related offence.

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Some corporations, particularly those with complex ownership structures, may find it burdensome or difficult to comply with these share register requirements. In these cases, incorporation or continuance under a provincial statute that does not have such a requirement, such as the *Business Corporations Act* (Ontario), may be considered by some companies, depending on the circumstances. However, we expect that the provinces will follow suit in due course by amending their respective corporate statutes to provide for similar requirements.

Our Take: CBCA Amendments May Prove Burdensome and Create Inconsistent Disclosure Regimes

By enshrining diversity disclosure, say-on-pay obligations and other corporate governance practices and principles into the corporate statute, the federal government is wading into areas that have largely been under the purview of provincial securities regulators or stock exchanges, or that have developed organically through the efforts of institutional investors and corporate governance influencers in Canada. Many may view the overlap and inconsistency between these new requirements and existing regulations and corporate governance practices as unnecessary, problematic and potentially quite burdensome. As many of the details have yet to be worked out, and most CBCA companies are only starting to implement the requirements, it remains to be seen to what extent these concerns will be justified. Importantly, with continued attention on corporations' appropriate purpose and the proper interests for directors and senior management to take into account in carrying out their duties, many will be anxious to see what, if any, impact the codification of modified *BCE* principles into the CBCA may have on the interpretation of directors' and officers' duties, and the application of the business judgment rule, in the future. In the meantime, directors and officers should remain attuned to the continued developments affecting their duties and reporting obligations, as well as evolving stakeholder expectations about how leaders carry out those responsibilities.

Notes

Chapter 1 – CBCA Reforms: Canadian Government Codifies Corporate Governance Practices

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

2 Davies, online: https://www.dwpv.com/en/Insights/Publications/2018/Governance-Insights-2018.

3 *Peoples Department Stores Inc. (Trustee of) v Wise*, 2004 SCC 68.

4 *Supra* note 2.

5 *Regulations Amending the Canada Business Corporations Regulations, 2001*, SOR/2019-258.

6 *Ibid*, section 72.2(4).

7 *Canada Gazette*, Part II, Volume 153, Number 14 (June 25, 2019), online: http://gazette.gc.ca/rp-pr/p2/2019/2019-07-10/html/sor-dors258-eng.html.