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Significant corporate governance changes in proposed amendments to the Canada Business Corporations Act

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On September 28, 2016, the Canadian federal government introduced *Bill C-25: An Act to amend the Canada Business Corporations Act et al.* The proposed amendments are the culmination of the first substantive review of the *Canada Business Corporations Act* (the CBCA) in 15 years and are the result of a consultation process initiated in 2013. The stated objectives of the proposed amendments are to, among other things:

- reform the process for electing directors of certain corporations;
- modernize communications between corporations and their shareholders; and
- require disclosure of information respecting diversity among directors and senior management.

What changes are proposed

Subject to any exceptions which may be prescribed by regulation, the following changes will apply to CBCA corporations with publicly traded securities or which are otherwise considered to be distributing corporations, including CBCA corporations listed on the Toronto Stock Exchange (the TSX), the TSX Venture Exchange and other stock exchanges:

- **Majority Vote Standard for Director Elections** — if at a meeting to elect directors, only one candidate is nominated for each position available on the board, shareholders will be able to vote "against" director nominees and each candidate is elected only if the number of votes cast "for" the nominee exceeds the number of votes cast "against" the nominee. If the vote results in the candidate not being elected, the board cannot appoint the candidate as a director before the next meeting of shareholders at which directors are to be elected. As discussed further below, this proposal would change the way public company directors are elected under the CBCA and is materially different from existing majority voting practices applicable to TSX-listed CBCA corporations.

- **Annual director elections** — all directors would have to be elected annually, consistent with existing requirements applicable to TSX-listed CBCA corporations. Accordingly, the CBCA would (subject to any exceptions provided for in regulations) entrench the prohibition on staggered boards (i.e. boards where only a certain number of directors are up for election each year (e.g. 1/3 per year)), a phenomenon that was once seen in some major Canadian public companies but that had largely fallen out of favour even before the TSX enacted its prohibition.

- **No slate elections** — each director would have to be elected separately, effectively prohibiting slate elections, consistent with existing requirements applicable to TSX-listed CBCA corporations.

- **Notice-and-access** — the CBCA Director would have the power to grant exemptions to permit corporations to provide shareholders with notice and online access ("notice and access") to financial statements and to permit corporations and dissidents to send proxy materials to shareholders using notice and access, but would not have the power to grant an exemption from the requirement to send diversity disclosure to shareholders.

- **Diversity disclosure** — corporations would have to provide to shareholders annual information to be prescribed by regulation respecting diversity among the directors and members of senior management. The backgrounder to the proposals indicates that the prescribed disclosure will address the representation of women on boards and in senior management through a "comply or explain" model and will require corporations to disclose their diversity representation and policies or explain why none are in place.

The proposed amendments also address various technical matters, such as prohibiting the use of bearer shares (to increase transparency of ownership) and requiring the CBCA Director to publish certain decisions with respect to exemptions granted under the CBCA.

What changes are not proposed

The 2013 consultation process sought and received comments on various other matters. Among other matters that some suggested be changed, the proposed amendments do not:

- require shareholder advisory votes on executive compensation (say-on-pay);
- address concerns respecting empty voting and over-voting;
- change substantive requirements governing when and how shareholders may submit nominees for directors to be included in the corporation's proxy circular (proxy access);
- require that chief executive officer and board chair roles be held by different persons;
- require shareholder approval of significantly dilutive transactions;
- require disclosure of social and environmental matters; or
- change director residency requirements.

Key takeaways

Majority Vote Standard

The proposed amendments as currently drafted are materially different from existing majority voting practices as required under TSX listing rules and no state or province in North America has adopted majority voting in the manner set out in the proposed CBCA amendments.

TSX-listed corporations are currently required to have a majority voting policy under which a director who receives more "withhold" votes than "for" votes in an uncontested election is required to tender a resignation, which members of the board who received a majority of "for" votes then consider whether to accept or reject.

The principal effect of the proposed amendments is to remove any role for the board when the majority vote standard has not been met for one or more director nominees. Under the proposed CBCA amendments, there is no opportunity for the board to make a determination as to whether or not to accept the resignation of a director who has received a majority "withhold" votes since the director would no longer have been elected in the first place. As a result, the proposed amendments would eliminate an important safeguard against the spectre of a "failed election" — i.e. an election that results in the elected directors being unable to act due to lack of quorum, or non-compliance with residency requirements under corporate law or independence requirements under securities laws or stock exchange rules.

An important benefit of the current TSX majority voting practices is that they provide shareholders with an avenue to express dissatisfaction with the performance of one or more of the directors. They therefore provide a springboard for board and shareholder engagement in circumstances where shareholders have decided not to put forward alternate director candidates. The proposed amendments may make shareholders who are dissatisfied with a specific decision of the board more reluctant to express their dissatisfaction through director "against" or "withhold" votes in light of the increased risk of a "failed election." By contrast, leaving responsibility with the board, the body which has a fiduciary responsibility to make decisions that are in the best interests of the corporation, to make a determination respecting the service of a director in light of the fact that the director failed to get a majority "for" vote allows for full consideration of all relevant circumstances and an opportunity for a meaningful dialogue with shareholders in order to understand and address the underlying problems which precipitated the vote result.

The proposed amendments also effectively assume that shares which have not been voted would be voted in the same manner and proportion as those whose votes were cast. It is by no means clear that this would be the case. For example, when instructing their broker on opening an account, beneficial shareholders may elect to receive meeting materials under NI 54-101 for all meetings, no meetings or only meetings at which special resolutions are considered. Those who choose to receive materials only for special meetings (many of whom are typically retail shareholders) may generally be prepared to support the nominees proposed in the corporation's proxy circular, while reserving their right to express a view on material transactions. In most circumstances contemplated by the proposed majority voting standard, the meeting will not involve a special resolution and such beneficial shareholders will not have been given an opportunity to vote "for" directors that, implicitly, they are currently prepared to support.

Diversity disclosure

Improving the level of diversity on boards and senior management has become a major political, cultural and corporate governance issue in Canada and can be expected to remain a public policy priority for some time to come. The proposed amendments contemplate a comply-or-explain disclosure approach, consistent with the approach taken under the securities laws of most Canadian jurisdictions, rather than mandating quotas as is required in some European jurisdictions. But while the backgrounder to the proposed CBCA amendments suggests that they are targeted at the representation of women, the federal government is proposing to give itself the flexibility to adopt regulations requiring disclosure of other diversity characteristics, including race. CBCA corporations will therefore need to take up this challenge in earnest.

TSX Venture issuers

CBCA corporations which are TSX Venture Exchange issuers are currently exempted from the majority voting, annual director election and individual voting requirements applicable to

TSX-listed CBCA corporations and from board and executive officer diversity disclosure obligations under Canadian securities laws. It is unclear to what extent, if at all, the regulations that would be enacted would continue to exempt TSX Venture Exchange corporations from such requirements.

Conclusions

The proposed amendments represent significant changes to the corporate governance of CBCA corporations. CBCA corporations and their boards of directors should review Bill C-25 with care and consider its potential application to their circumstances. We look forward to the opportunity to contribute to the debate with respect to these proposed amendments.