BACKGROUNDER

SUMMARY OF AMENDMENTS TO THE CANADA BUSINESS CORPORATIONS ACT

Amendments to the *Canada Business Corporations Act* (CBCA) and the *Canada Cooperatives Act* (CCA) tabled today in the Senate will enhance corporate governance in Canada, improve the ability of Canadian corporations to compete in the marketplace, and reduce costs for Canadian businesses. This reflects the commitment of the Government of Canada in the Speech from the Throne to increase trade and investment by modernizing legislation, making Canada a choice destination for the headquarters of global corporations.

The *Canada Business Corporations Act* sets out the legal and regulatory framework for more than 155,000 businesses, including 249 of the 1999 Financial Post Top 500 corporations in Canada. The Act has not been substantially amended since 1975. Although the CBCA is still a sound and effective business corporate law, several sections need to be reformed or updated.

The CBCA proposals build on extensive consultations that started in 1994, with several hundred stakeholders taking part. The amendments also incorporate recommendations from the consultations and reports of the Standing Senate Committee on Banking, Trade and Commerce on corporate governance and related issues.

The amendments to the *Canada Cooperatives Act* (CCA) continue the reform process that recently led to a new statute governing cooperatives in Canada. The new CCA, which came into force on December 31, 1999, set aside some issues which are now addressed in this reform.

Leading-edge marketplace framework laws such as the CBCA and the CCA are the cornerstone of a fair, efficient and competitive marketplace – an essential foundation for investment, innovation, trade and economic growth in the knowledge-based economy.

The Conference Board of Canada recently pointed out "companies that excel in governance practices post higher long-term profit growth, experience faster sales increases and are much more likely to be leading companies in their sector."

The proposed amendments will expand shareholder rights, enhance global competitiveness, clarify responsibility, eliminate duplication and reduce costs.

The highlights of the amendments to the CBCA are listed below. The highlights of the amendments to the CCA are set out in a separate background document.

1. EXPANDING SHAREHOLDER RIGHTS

Corporate statutes establish the rights of shareholders to participate in the major decisions of the corporations in which they have an interest. For shareholders to exercise these rights, they must have access to corporate information in a timely manner, be able to make an informed decision on what that information means, and be prepared to vote, in person or by proxy. The facilitation of this process

is designed to help ensure that management decisions are in the best interests of the corporation. The Bill will allow shareholders to more freely communicate with the corporation and one another and will liberalize the existing shareholder proposal system.

Shareholder Communications and Proxy Rules

Current CBCA rules do not allow shareholders to discuss matters relating to the corporation "under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy," unless a proxy circular is sent, at the shareholder's expense, to all other shareholders. This inhibits shareholder communications and the monitoring of corporate performance.

Proposed amendments:

- increase the rights of shareholders to communicate among themselves as long as there is no solicitation of a proxy, and
- allow solicitations by public broadcast or publication in prescribed circumstances.

The amendments will facilitate discussions among shareholders in respect of corporate performance and other matters of direct interest to all shareholders. They will eliminate unnecessary obstacles to the exchange of views and opinions by shareholders and others concerning management performance and initiatives presented for a vote of shareholders.

Allowing proxy solicitations by public broadcast or newspaper advertisement in some circumstances will lower the costs to shareholders and others of conducting a proxy solicitation.

Shareholder Proposals

Shareholder proposals are an important mechanism for shareholders to monitor corporate performance and influence corporate behaviour. The current rules do not allow beneficial shareholders (e.g., shareholders who hold their shares through a securities firm and are not registered owners with the corporation) to make proposals.

Proposed amendments:

- liberalize the mechanisms for individual shareholders to submit proposals, and
- set minimum share ownership and length of ownership requirements as a prerequisite for submitting a proposal.

The amendment would allow beneficial shareholders to have proposals circulated for consideration at shareholders' meetings. Furthermore, the scope for rejection by the management of a proposal, where the proposal relates significantly to the affairs of the corporation, will be reduced.

The requirements for minimum shareholdings and for the minimum length of time for owning shares are intended to ensure that proposals are founded on a genuine stake and interest in the affairs of the corporation. At the same time, provisions will allow the pooling of shareholdings to meet the minimum requirements. This will improve the right of shareholders to submit proposals, without forcing

them to purchase additional shares. The amendments, taken together, will thereby allow wider participation by small shareholders in corporate decision making.

Electronic Communications

The current Act permits corporations to communicate electronically with government. However, it only permits paper-based communications with shareholders.

Proposed amendment:

- permit corporations to employ new and emerging technologies to communicate with shareholders.

This will encourage corporations to employ new technologies and lower costs to them and their shareholders.

Paper-based communications will not be eliminated. Rather, the amendments will allow communication to be done electronically if the shareholder consents. Shareholders will have the option of insisting on paper-based communications. Similarly, shareholders would not be able to force the corporation to send information electronically if the corporation wishes to continue using paper.

2. ENHANCING GLOBAL COMPETITIVENESS

A leading-edge corporate law must encourage innovation, investment and risk-taking, in step with the challenges and opportunities of a global economy. The CBCA must be responsive to the needs of Canadian corporations as they become global players. It must also foster a favourable environment to encourage foreign investors to establish in Canada a base for global operations. In the Speech from the Throne, the Government committed to increase trade and investment by modernizing legislation, making Canada a choice destination for the headquarters of global corporations. The Bill allows stronger international representation on the boards of CBCA corporations and improves the defences available to directors as they carry out their duties and assume risk.

Directors' Residency Requirements

The CBCA currently requires a majority of directors on the board and on each committee of the board of CBCA corporations to be resident Canadians. Canada is the only jurisdiction in the G-7 that imposes residency requirements.

Proposed amendments:

- reduce the residency requirement to 25 per cent for boards of directors, except for sectors and corporations that are subject to ownership restrictions; and
- eliminate the residency requirement for committees of the board.

The changes to the residency requirements will provide Canadian corporations with added flexibility as they become global players. Stronger international representation on the boards of corporations may be helpful to develop export markets, pursue global investments and alliances, or simply achieve a mix of skills and background adapted to the competitive circumstances of the firm.

This reduction in the residency requirement will not apply where federal legislation or policy impose ownership restrictions. This includes the uranium, book publishing, broadcasting, telecommunications, film and video distribution, and domestic transportation services sectors. Similarly, this reduction will not apply to corporations that individually are subject to ownership restrictions such as Air Canada, Petro-Canada and the Canadian National Railway Corporation.

Eliminating the residency requirement for committees provides corporations the flexibility to appoint directors to committees based on their qualifications. The board remains responsible for approving recommendations made by committees.

Quebec, Nova Scotia, New Brunswick, Prince Edward Island and the three territories do not have residency requirements in their corporate law.

Directors' Liability

The CBCA currently provides a "good faith reliance" defence for directors. This defence protects directors if they rely in good faith on financial statements or reports supplied by lawyers, accountants, engineers, appraisers, or other professionals. This is a restriction in as much as decision making must also be made on the basis of subjective analysis and judgement.

In addition, the CBCA does not clearly indicate whether defence costs can be advanced and whether directors should be indemnified for all legal proceedings, including investigations. Such proceedings can be costly and lengthy.

Proposed amendments:

- replace the good faith reliance defence with a due diligence defence, and
- broaden the statutory indemnification rules to allow corporations to advance defence costs and indemnify directors for all legal proceedings, including investigations.

A due diligence defence recognizes that a director's actions and the expected precautions will vary depending on the circumstances. The defence provides that a director would not be liable if he or she exercised the degree of care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances. This allows directors to take appropriate decisions, and assume risk, with the confidence that reasonable defences are available in the event of challenges.

The proposed change to indemnification rules would help ensure that directors are adequately protected against the costs of all types of proceedings.

The amendments would not protect directors who engage in fraudulent or otherwise illegal activities.

3. CLARIFYING RESPONSIBILITY

Sound corporate governance starts with a clear accountability framework that fosters responsibility. This includes a fair and efficient allocation of liability. The Bill introduces a regime of

modified proportionate liability in respect of the provision of financial information required under the CBCA. It also clarifies liability rules under unanimous shareholder agreements.

Modified Proportionate Liability

Currently, individuals who are found negligent in the preparation of financial information are subject to joint and several liability. The injured party can seek full compensation from any of the defendants found liable. The injured party, therefore, has an incentive to pursue the most accessible and creditworthy defendant regardless of fault. It is then left up to that defendant to recover contributions from the other negligent defendants.

The Standing Senate Committee on Banking, Trade and Commerce, after studying this issue in detail and consulting with many stakeholders, concluded that the current regime of joint and several liability could have adverse implications on the financial reporting system and capital markets.

Proposed Amendments:

- provide for a regime of modified proportionate liability for persons involved in the preparation of financial information required by the CBCA and regulations.

The amendments provide that every defendant found responsible for a financial loss arising out of an error, omission or misstatement in financial information that is required under the Act or the regulations would be liable to the plaintiff for the portion of the damages corresponding to the defendant's degree of responsibility. Reallocation of responsibility amongst the parties is provided for in the event one or more defendants are insolvent or unavailable. The joint and several liability regime would continue to be applicable to designated categories of plaintiffs, specifically the Crown, charitable organizations, unsecured trade creditors and individual plaintiffs whose investment in the corporation is below a prescribed threshold. In cases of fraud, the defendant would always be subject to joint and several liability.

Unanimous Shareholder Agreements

A unanimous shareholder agreement (USA) is an agreement among all shareholders of a corporation that transfers some or all of the powers of directors to shareholders. The current Act does not clearly specify that when the powers are transferred to shareholders the liabilities and associated defences are also transferred.

In addition, the Act does not clearly provide protection for a shareholder who unknowingly purchases shares in a CBCA corporation that has a USA in place.

Proposed amendments:

- clarify that when the directors' powers are transferred to shareholders under a USA the liabilities are also transferred, and
- permit new shareholders who are not informed that a USA is in place to cancel the transaction.

The object of the amendments is clarification. They will clearly indicate that, along with powers and duties, all associated liabilities will be transferred to shareholders. This will increase certainty for users of USAs. At the same time, they will clarify that defences to liabilities which would have been available to the directors are available to the shareholders.

The amendments will also permit new shareholders to cancel their acquisition of securities if they were not informed that a unanimous shareholder agreement was in place at the time of acquisition.

4. ELIMINATING DUPLICATION AND REDUCING COSTS

In some circumstances, CBCA corporations currently are required to comply with conflicting federal and provincial statutes and regulations. This can result in costly and time-consuming administrative and legal burdens. There are also a number of areas where the CBCA is out-of-date with administrative, legal and technical developments. The Bill will eliminate duplication and modernize wording and terminology.

Insider Trading

Currently, both the CBCA and provincial securities laws require that all insiders of publicly-traded corporations file periodic insider reports. The CBCA provisions are duplicative.

At the same time, civil liability provisions in the CBCA (which allow those harmed to take an action) are unclear and inadequate. Additionally, the fine for breach of the prohibitions against certain insider trades, such as short selling, is only $5,000.

Proposed amendments:

- repeal the insider reporting requirements,
- clarify and expand the scope of civil liability provisions, and
- increase the maximum fine for certain improper insider trades (e.g., short selling) from $5,000 to $1,000,000 or three times the profit made or loss avoided, whichever is greater.

These amendments would: remove the CBCA filing requirements and eliminate duplication, clarify the wording of existing provisions, and impose civil liability on persons who communicate undisclosed confidential information, regardless of whether or not a transaction occurs.

Takeover Bids

Generally, a takeover bid is an offer to shareholders to purchase shares of a target (offeree) corporation, where the offeror, if successful, will obtain enough shares to control the target corporation.

The primary objective of the CBCA's takeover bid provisions is to ensure that the rights and interests of the various parties involved in a takeover bid -- shareholders, the offeror and the target corporation – are adequately protected. The provincial securities laws provide comprehensive codes for the regulation of takeover bids of publicly-traded companies. The combined reach of the various provincial securities laws operate to cover all bids for publicly-traded CBCA corporations.

Proposed amendment:

- repeal the takeover bid provisions.

This would eliminate redundant regulation as well as compliance costs in an area already regulated by provincial securities laws.

Going-private Transactions

Going-private transactions (GPTs) refer to amalgamations, arrangements, consolidations or any other transaction, with respect to distributing corporations that would result in the termination of shareholder interests with compensation but without consent. Squeeze-outs are similar transactions in the context of a non-distributing (private) corporation. Currently, the CBCA sets out rules for one type of GPT (compulsory acquisitions), but is silent on whether other forms of GPT are permitted.

Proposed amendments:

- expressly permit GPTs for distributing corporations, subject to compliance with specific fairness criteria, and
- provide that squeeze-out transactions must be approved by the majority of affected shareholders.

The amendments would define a GPT in the regulations and specify that such transactions are allowed, subject to compliance with prescribed fairness criteria set out in the applicable rules or policy statements issued by the Ontario and Quebec Securities Commissions (which would be incorporated by reference in the regulations).

These safeguards are not required in the case of squeeze-out transactions, which apply only to non-distributing corporations. In most cases, the shareholders of private corporations are intimately aware of the financial situation and prospects of the corporation.

Financial Assistance

The CBCA restricts the provision of loans, guarantees and other kinds of financial assistance to directors, officers, employees and shareholders by a CBCA corporation where the directors have "reasonable grounds for believing that" either the corporation is or would become insolvent or the corporation's assets are or would be less than all of its liabilities and stated capital.

This requirement has proven difficult to apply in practice. The solvency test and the potential liability can impede legitimate financial transactions that may be in the best interests of the corporation.

Proposed amendment:

- repeal the provision on financial assistance.

Directors approving financial assistance transactions are subject to statutory fiduciary duties to act in the best interests of the corporation, and they can be sued for failure to do so. This provides adequate safeguards.

Technical Amendments

A wide-ranging set of technical amendments are proposed. These will clarify ambiguous wording, update terminology, and eliminate regulatory and paper burden.