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Corporate Governance: Where Things Stand for 2008

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This bulletin summarizes notable developments in corporate governance as we head into the 2008 annual meeting and reporting season.

Executive Compensation

The CSA (Canadian Securities Administrators) has delayed implementation of new executive compensation disclosure rules. After reviewing comments from market participants, the regulators decided they will publish revised proposals in 2008. The original proposals were very similar to the SEC's executive compensation disclosure rules, which apply only to U.S. domestic companies. For details about the original proposals, please refer to our client memo [Canadian Securities Regulators Propose New Rules for Executive Compensation Disclosure](#) (April 10, 2007). It remains to be seen how closely the CSA will follow the U.S. requirements.

In January 2008, the Canadian Coalition for Good Governance (CCGG) released its latest score card on executive compensation and identified four areas for improvement:

- ensuring that compensation consultants are hired by the board, that any extra services are approved by the board and that consultants' fees are disclosed;
- providing a single figure for the CEO's pay and demonstrating that past stock grants are taken into account in setting compensation;
- abandoning options that vest over time with no performance hurdles; and
- explaining clearly how compensation packages are tied to performance in the short- and long-term.

Shareholders of U.S. companies are expected soon to be entitled to a non-binding vote on executive compensation at annual meetings – popularly referred to as a “say on pay.” The proposed U.S. legislation does not apply to foreign private issuers, including Canadian companies that access the U.S. market using the MJDS (multijurisdictional) system. In Canada, shareholder voting on executive compensation will be a topic of debate in the coming months, given the heightened focus of regulators and institutional investors on executive compensation issues. Whether say-on-pay is ultimately adopted here, or recommended by the CCGG or Institutional Shareholder Services, may depend on related developments such as the perceived effectiveness of the CSA's

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pending executive compensation disclosure rules and continuation of the trend toward majority voting in directors' elections. For 2008, Institutional Shareholder Services is recommending that shareholders vote in favour of say-on-pay proposals, not necessarily with a view to companies adopting the practice, but with a view to shareholders being entitled to resubmit say-on-pay proposals next year.

Indemnification of Directors and Officers Under the OBCA

The OBCA (*Business Corporations Act (Ontario)*) indemnification provisions were amended in 2007 and are now consistent with the comparable CBCA (*Canada Business Corporations Act*) provisions. The changes are as follows:

- Indemnification is permitted not just in civil, criminal and administrative matters but also in investigations and other kinds of proceedings, such as investigations by a securities commission (OBCA s. 136(1)).
- Indemnification may be provided to individuals who acted, at the corporation's request, in any role similar to that of a director or officer of another entity (including a non-corporate entity), even if the corporation is neither a shareholder nor a creditor of the other entity, as long as the indemnified individual acted in the best interests of the other entity and certain other conditions were fulfilled (OBCA s. 136(1), (3) and (4.1)).
- Corporations may advance money to fund a director's, officer's or other individual's defence to a claim. With court approval, corporations may also advance money in derivative actions. In all cases, the advancements must be repaid if the individual is found not to have acted honestly, in good faith and with a view to the best interests of the relevant entity (OBCA s. 136(2) and (3)).
- Individuals will be entitled to indemnification as long as they are not judged by a court or other authority to have committed any fault or omitted to do anything that ought to have been done (as opposed to being entitled to indemnification only if they were "substantially successful" on the merits of a proceeding, which requires a trial and not just a settlement). The good faith requirement in this context has not changed (OBCA s. 136(4.2)).
- Restrictions on insurance coverage have been removed so that corporations may insure directors, officers and individuals acting at the corporation's request in similar capacities at other entities, even if the liability relates to the person's failure to act honestly, in good faith or in the best interests of the corporation or other entity (OBCA s. 136(4.3)).

Proxy Solicitation

The OBCA has been amended to exempt certain "solicitation" activities from the dissident information circular requirements, consistent with the CBCA. Dissidents may solicit proxies without sending a circular as long as the total number of shareholders solicited is 15 or fewer, or the solicitation is conveyed by public broadcast, speech or publication and with certain disclosure as part of the solicitation.

The CSA has proposed a similar exemption from the information circular requirements of NI 51-102 to allow dissident shareholders to solicit proxies without preparing an information circular if the solicitation is conveyed by public broadcast, speech or publication and with certain disclosure. The comment period for this proposal closed on January 11, 2008. The CSA's objective is to ensure that securities legislation does not prevent shareholders from exercising rights available to them under corporate law.

Other OBCA Amendments Relating to Corporate Governance

Duty of Care Owed Exclusively to the Corporation

In the 2004 case of *Peoples Department Stores v. Wise*, the Supreme Court of Canada held, among other things, that directors of CBCA corporations owe their duty of care not just to the corporation but also to other stakeholders, such as creditors. The Court's broad interpretation of the duty of care was unexpected, and the OBCA was correspondingly amended to clarify that under that statute, the duty of care is owed exclusively to the corporation (s. 134(1)).

Good Faith Reliance Defence Also Requires Due Diligence

Under section 130 of the OBCA, directors are liable to the corporation if they approve certain improper transactions, such as share issuances for inadequate non-money consideration and improper dividend payments. More generally, directors have a duty under section 134(2) to comply with the OBCA and its regulations, the corporation's articles and by-laws, and any unanimous shareholder agreement. Section 135(4) enumerates certain circumstances in which directors can avoid liability under sections 130 and 134(2), and has been amended as follows:

- To avoid liability, directors must exercise the care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances. Contrary to the old provision, good faith reliance on financial statements or reports of experts is no longer necessary or sufficient to ground the defence.
- Exercising reasonable care now includes reliance in good faith on
 - interim or other financial reports (in addition to annual financial statements, reliance on which was permitted under the old provision); and
 - reports or advice from officers or employees, if reliance was reasonable in the circumstances (these are in addition to reports of experts such as lawyers, appraisers or engineers, reliance on which was permitted under the old provision).

Shareholder Proposals

Beneficial and not just registered owners may now submit shareholder proposals. The word limit for the combined proposal and supporting statement is now 500, rather than 200 for the supporting statement alone (ss. 99(1), (3.1) and (11), and O. Reg. 23.4).

Directors' Residency Requirements

Instead of a majority of resident Canadian directors, OBCA corporations need only 25% resident Canadian directors. Moreover, residency requirements for the managing director, for board meetings, and for committee membership have been dropped (ss. 118(3), 126(6) and (7) and 127(1)).

Conflicts of Interest

For purposes of disclosing potential conflicts of interest, if a director or officer has provided general notice to the board of directors of a material interest in another entity, the director or officer must subsequently inform the board of any material change in his or her interest. Furthermore, a conflicted director may not attend any part of a meeting during which the relevant contract or transaction is discussed (ss. 132(5) and (5.2)).

Sending Financial Statements

Offering corporations need to send annual and interim financial statements only to shareholders who request them, instead of to all shareholders except those explicitly opting out. This is consistent with NI 51-102, but the CBCA still requires materials to be sent unless a shareholder opts out (ss. 154(3) and 160).

CSA Review of Best Practices and Disclosure Requirements

The CSA will be undertaking a broad review of existing guidelines for best practices in corporate governance (NP 58-201) and related corporate governance disclosure requirements (NI 58-101). The regulators plan to publish their findings and any proposed amendments for comment in 2008.

CEO/CFO Certifications and Internal Controls

After reviewing and considering the comments on its 2007 proposals related to CEO and CFO certifications, the CSA decided to make significant changes and will be publishing revised proposals in 2008. Although the substance of the changes will be known only once a new proposal is published, the regulators have said that the certification requirements for venture issuers will be substantially reduced. As a result, pending new rules, CEOs and CFOs of venture issuers are permitted to remove references in their certifications to the establishment and maintenance of disclosure controls and internal controls.

Under the 2007 proposals, CEOs and CFOs would have had to evaluate the issuer's internal controls and disclose in MD&A whether or not the controls were effective and any remediation plans related to "reportable deficiencies." There was no proposal for issuers' external auditors to provide opinions on internal controls, unlike in the United States. Pending new Canadian rules, cross-border issuers still have to comply with the U.S. internal control rules. The SEC has recently attempted to make the U.S. rules less onerous by

- proposing that the compliance deadlines for the smallest issuers be extended by an additional year;
- publishing guidance for management on how to evaluate a company's internal controls using a top-down, risk-based approach;
- eliminating the requirement for auditors to evaluate management's assessment of internal controls, and requiring them only to provide an opinion on the actual effectiveness of the controls; and
- redefining the term "material weakness" using a reasonableness standard so that fewer weaknesses have to be reported.

For more detail on the SEC's initiatives and an explanation of how the Canadian proposals would have differed from the U.S. rules, please see our client memo [SEC Issues Guidance on Internal Control Rules and Redefines "Material Weakness"](#) (June 25, 2007).

TSX Considers Securityholder Approval Requirements for Acquisitions

The TSX is considering requiring securityholder approval when a listed company issues securities to acquire a public company. The TSX requested comments on the appropriate level of dilution that would trigger the voting requirement and the proportion of votes that would be necessary to approve the issuance. The TSX rules currently require securityholder approval for issuances in excess of 25% of the outstanding securities of the listed issuer, but this requirement does not apply when a public company is being acquired (unless a significant portion of the securities are being issued to insiders or the issuance would materially affect control of the listed company). 