Canada

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CORPORATE ENTITIES

Business corporations are formed under either the federal Canada Business Corporations Act (CBCA) or under an equivalent provincial statute, such as the Business Corporations Act (Ontario). Unincorporated vehicles, such as trusts or limited partnerships, had until recently been becoming more popular, although changes in Canadian tax laws have removed most of their flow-through tax benefits and they are becoming less common, particularly for public issuers.

This article focuses on CBCA-incorporated companies, although the provincial business corporations statutes are broadly similar on corporate governance and related matters.

Financial institutions typically incorporate under federal legislation (such as the Bank Act). The federal legislation's governance provisions are based on and largely derived from the CBCA.

LEGAL FRAMEWORK

1. What is the regulatory framework for corporate governance and directors' duties?

Corporate governance rules and policies derive from two main sources:

- Statutes such as the CBCA. The CBCA requires a company to have a board of directors (board) and sets out the fiduciary standards that directors must meet in carrying out their functions and for their various other responsibilities (*see Question 15*).
- Securities legislation and the rules and policy statements of Canadian securities regulators. These include:
  - a rule (*National Instrument 52-110 - Audit Committees*) providing a number of mandatory requirements for audit committees in publicly traded companies (*see Question 14*);
  - a policy statement (*National Policy 58-201 - Corporate Governance Guidelines*) outlining Canadian securities regulators' corporate governance recommendations, with an associated disclosure rule (*National Instrument 58-101 - Disclosure of Corporate Governance Practices*) requiring public companies to compare their approach against the recommended practices (a comply or explain approach).

2. Has your jurisdiction adopted a corporate governance code? If yes:

- **What is the name of the code? What areas are covered by it (for example, board composition and committees, remuneration, audit and risk)?**
- **How is the code structured (for example, a set of rules or principles and provisions)? What type of companies must comply with the code?**
- **Is the code based on the comply or explain principle? How are companies required to report their application and compliance with the code (for example, in their annual report)?**
- **What are the consequences of non-compliance with the code?**
- **What has been the general response of companies, regulators and shareholder groups to the comply or explain approach? Has it been popular or controversial? Are there plans to reform it?**

National Policy 58-201 (*see Question 1*) addresses the following corporate governance issues:

- Board composition and independence.
- Board mandates.
- Position descriptions (including chairman and chief executive officer (CEO)).
- Orientation and continuing education for directors.
- Adoption of a written code of business conduct and ethics.
- Nomination of directors (including board nominating committees).
- Compensation of executives (including board compensation committees).
- Regular board assessments.

National Policy 58-201 is structured as a set of guidelines. It applies to all publicly traded companies.

National Policy 58-201 and the associated disclosure rule, National Instrument 58-101 (*see Question 1*) apply a comply or explain approach. Companies are required to provide their disclosure in their annual shareholder meeting materials, or explain why they have not provided disclosure. Failure to comply with the disclosure rule is a breach of securities laws and subject to enforcement by securities regulators.

Due to a greater number of smaller companies and controlled companies in Canada than in the US, the comply or explain approach is considered most appropriate. However, securities regulators have expressed concern about the use of boilerplate disclosure.

BOARD COMPOSITION AND REMUNERATION OF DIRECTORS

3. What is the management/board structure of a company? In particular:

- **Is there a unitary or two-tiered board structure?**
- **Who manages a company and what name is given to these managers?**
- **Who sits on the board(s)?**
- **Do employees have a right to board representation?**
- **Is there a minimum or maximum number of directors or members of the managerial and supervisory bodies?**

- **Structure.** Companies have a unitary board structure.
- **Management.** The board oversees the management of the company by the officers of the company (including the CEO and the chief financial officer (CFO)).
- **Board members.** Board members are a combination of independent directors, management directors and shareholder representatives.
- **Employees' representation.** Employees do not have a right to representation.
- **Number of directors or members.** There must be a minimum of (*CBCA*):
  - one director, for companies that are not publicly traded;
  - three directors, for publicly traded companies.

  There is no limit on the maximum number of directors.

4. Are there any age or nationality restrictions on the identity of directors?

Age restrictions

Directors must be at least 18 years of age (*CBCA*).

Nationality restrictions

At least 25% of the directors must be Canadian residents (*CBCA*).

5. In relation to non-executive, supervisory or independent directors:

- **Are they recognised?**
- **Does a part of the board have to consist of them? If so, what proportion?**
- **Do non-executive or supervisory directors have to be independent of the company? If so, what is the test for independence or what makes a director not independent?**
- **What is the scope of their duties and potential liability to the company, shareholders and third parties?**

- **Recognition.** Independent directors are a common feature in Canadian companies and have identical standing to other directors.
- **Board composition.** Publicly traded companies must have a minimum of two non-management directors. Senior exchange companies must have an audit committee with a minimum of three independent directors (independence being a more difficult standard to meet than non-management). Generally, a majority of board members of publicly traded companies are independent. For non-publicly traded companies, the board members tend to be a combination of management directors and shareholder representatives.
- **Independence.** To be independent, a director cannot be:
  - an employee of the company;
  - a partner or employee of the company's auditor;
  - a family member of an executive officer;
  - an officer of an entity in which an executive officer of the company serves on the compensation committee; or
  - in receipt of remuneration from the company for services in excess of specified amounts (Can$75,000 (as at 1 April 2011, US$1 was about Can$1) for non-audit committee members; any amount for audit committee members), except in connection with board-related services.
- **Duties and liabilities.** Independent directors have the same duties and liabilities as other directors (*see Question 15*).

6. Are the roles of individual board members restricted? For example, can one person be the chairman and chief executive?

The roles of individual board members are not restricted. The same person can be both chairman and chief executive, although for publicly traded companies this is increasingly uncommon.

7. How are directors appointed and removed? Is shareholder approval required?

Appointment of directors

Directors are appointed by the shareholders by an ordinary resolution at a general meeting.

Removal of directors

Directors can only be removed by the shareholders by an ordinary resolution at a general meeting.

8. Are there any restrictions on a director's term of appointment?

There are no restrictions on a director's term of appointment, although these may be given in the company's bye-laws. Where a director is not elected for an expressly stated term, the director's appointment ceases at the close of the next annual meeting.

9. Do directors have to be employees of the company? Can shareholders inspect directors' service contracts?

Directors employed by the company

Directors do not have to be employed by the company.

Shareholders' inspection

Directors do not typically have service contracts. Where directors' service contracts do exist, shareholders do not have a right to inspect them.

10. Are directors allowed or required to own shares in the company?

Directors are allowed, but not required, to own shares in the company. Many companies now impose minimum share ownership requirements so that directors have a financial stake in the companies they serve.

11. How is directors' remuneration determined? Is its disclosure necessary? Is shareholder approval required?

Determination of directors' remuneration

Directors determine their own remuneration. However, director remuneration is not significant in most companies.

Disclosure

Publicly traded companies must disclose director remuneration in their annual proxy materials.

Shareholder approval

Shareholder approval of director remuneration is not required.

MANAGEMENT RULES AND AUTHORITY

12. How is a company's internal management regulated? For example, what is the length of notice and quorum for board meetings, and the voting requirements to pass resolutions at them?

A company's internal management is normally regulated by its bye-laws, which must be approved by shareholders. The bye-laws typically specify required notice and notice periods. Certain matters to be discussed at a board meeting must be specified in the notice, although directors can waive the notice requirement at the meeting. Quorum for board meetings is also typically set in the bye-laws. If not set in the bye-laws, a quorum is a majority of the number of directors. Normally, resolutions must be approved by a majority of the board to be passed.

13. Can directors exercise all the powers of the company or are some powers reserved to the supervisory board (if any) or a general meeting? Can the powers of directors be restricted and are such restrictions enforceable against third parties?

Directors' powers

Directors can exercise all the powers of a company, subject to certain actions that require shareholder approval, which include:

- Amending articles of incorporation.
- A sale of all or substantially all of the company's assets.
- Amalgamations involving the company.
- Arrangements of the company.

Restrictions

Directors' powers can be restricted by a unanimous shareholder agreement (or a directive from the shareholder where there is only one shareholder). Restrictions given by a unanimous shareholder agreement are enforceable against third parties. However, a company cannot assert that a unanimous shareholder agreement has not been complied with against a person dealing with the company, except where the person has (or ought to have) knowledge of the restriction.

14. Can the board delegate responsibility for specific issues to individual directors or a committee of directors? Is the board required to delegate some responsibilities, for example for audit, appointment or directors' remuneration?

The board can delegate to committees, individual directors or management where appropriate, in accordance with their responsibilities. However, directors cannot rely on management where it would be unreasonable to do so in the circumstances. In addition, certain matters cannot be delegated by the board, including the power to (*CBCA*):

- Appoint directors and auditors where there is a vacancy.
- Issue securities (except as authorised by the board).
- Purchase or redeem shares.
- Declare a dividend.
- Approve annual financial statements.
- Approve certain disclosure documents.

In publicly traded companies, the board must form an audit committee and delegate to it responsibility for (*National Instrument 52-110 - Audit Committees*):

- Overseeing the work of the auditor.
- Resolving any disputes between management and the auditor.
- Recommending the auditor.

The Canadian securities regulators' best practice guidelines recommend that publicly traded companies also have independent board nominating committees and compensation committees.

DUTIES AND LIABILITIES OF DIRECTORS

15. What is the scope of a director's duties and personal liability to the company, shareholders and third parties? Please distinguish between civil and criminal liability under each of the following (if relevant):

- **General duties.**
- **Theft and fraud.**
- **Securities law.**
- **Insolvency law.**
- **Health and safety.**
- **Environment.**
- **Anti-trust.**
- **Other.**

- **General duties.** The main duties of all board members of CBCA companies are:
  - a duty of care, that is, a requirement to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances; and
  - a duty of loyalty, that is, a duty to act honestly and in good faith, with a view to promoting the best interests of the company.

  Directors can have personal liability for breaches of these duties, typically through a derivative action initiated by shareholders on behalf of the company. Directors can also have personal liability to shareholders or creditors where the powers of the directors are exercised in a manner that is oppressive or unfairly prejudicial to, or unfairly disregards the interests of, shareholders or creditors. Directors can also have liability under common law tort principles to third parties for their conduct as directors.
- **Theft and fraud.** Directors can face liability under the Criminal Code for acts of theft and/or fraud.
- **Securities law.** Directors face both civil liability (to security holders) and regulatory liability (including fines and imprisonment) for breaches of securities laws. These include, for example, being involved in the issuance of securities law documents (prospectuses, circulars, financial statements, and so on) that were fraudulent or contained material misrepresentations, or being involved in insider trading and tipping.
- **Insolvency law.** Directors must ensure that the company carries on business only if it can meet its liabilities as they become due and there is a reasonable expectation of newly incurred obligations being satisfied. Directors can be personally liable if the company conducts business while insolvent. In an insolvency, certain other claims may also be made against directors, including:
  - claims by employees for wages; and
  - claims by the company (and trustees in bankruptcy) against directors who vote for or consent to corporate finance actions such as loans, guarantees, payments of dividends or redemptions of shares.
- **Health and safety.** Directors must take all reasonable care to ensure that the company they serve protects the health and safety of its workers and complies with Ontario's Occupational Health and Safety Act (OHSA) or equivalent statutes in certain other provinces and territories, and all regulations made or orders issued under these statutes. In several cases, directors have been convicted of offences for violating the OHSA, particularly where a director had significant involvement with the operations of the company and did not take all reasonable steps to ensure that the company complied with the OHSA. In rare cases, directors can be held criminally responsible under the Criminal Code for workplace health and safety matters.
- **Environment.** Federal and certain provincial statutes impose a duty on directors and officers to take all reasonable care to prevent the companies they serve for from unlawfully discharging contaminants into the natural environment and contravening other environmental laws. Reasonable care typically includes:
  - establishing an environmental policy;
  - implementing a proper system to prevent breaches of environmental laws; and
  - taking reasonable steps to monitor compliance with policies and the effective operation of the system.

  Failure to meet environmental requirements can lead to significant fines and imprisonment.
- **Anti-trust.** The Competition Act contains criminal and civil provisions proscribing a variety of anti-competitive conducts, including:
  - price-fixing;
  - bid-rigging;
  - deceptive marketing; and
  - abuse of a dominant position.

  These offences are punishable by:
  - prison terms of up to 14 years;
  - fines at the discretion of the court;
  - administrative monetary penalties of up to Can$10 million.

  Enforcement extends to prosecuting individuals such as directors, officers and employees of the company. In some cases, any director or officer of the company who was in a position to direct or influence the policies of the company in relation to the prohibited conduct can be considered guilty of the offence.
- **Other.** Directors face personal liability under various other statutes, including those relating to:
  - employment and labour;
  - taxation (such as on income, health, retail sales, goods and services, and customs and excise); and
  - pensions.

16. Can a director's liability be restricted or limited? Is it possible for the company to indemnify a director against liabilities?

In the case of a unanimous shareholder agreement, a director's liability is limited to the extent that the powers of the director are restricted by the agreement.

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It is possible (and typical) for the company to indemnify a director against liabilities, subject to both:

- The director satisfying his duty to act honestly and in good faith with a view to promoting the best interests of the company.
- In the case of a criminal or administrative action or proceeding that is enforced by a monetary penalty, his having had reasonable grounds for believing that his conduct was lawful.

Where these conditions are met, and with court approval, a company can also indemnify directors and former directors against costs and expenses incurred in relation to actions by or on behalf of the company.

A director or former director is also entitled to be indemnified by the company for amounts reasonably incurred in successfully defending an action or proceeding to which he is a party due to his directorship.

17. Can a director obtain insurance against personal liability? If so, can the company pay the insurance premium?

Under the CBCA, a director can obtain insurance against personal liability and the company can (and typically does) pay the insurance premium.

18. Can a third party (such as a parent company or controlling shareholder) be liable as a de facto director (even though such person has not been formally appointed as a director)?

A shareholder can be liable as a director where the powers of the director have been limited under a unanimous shareholder agreement, although the scope of this liability is unclear. A controlling shareholder owes no fiduciary or other duty to minority shareholders except that it cannot use its position to act in a manner that is oppressive to minority shareholders.

TRANSACTIONS WITH DIRECTORS AND CONFLICTS

19. Are there general rules relating to conflicts of interest between a director and the company?

A director cannot divert opportunities that could be of interest to the company for personal benefit or the benefit of another business. Each director must disclose in writing the nature and extent of the director's interest in a material transaction (or proposed transaction) with the company. The director must also refrain from voting on a resolution to approve the contract or transaction except in narrow circumstances (such as a contract relating primarily to the director's compensation) (*CBCA*).

In publicly traded companies, the securities rules prohibit material contracts and transactions between a director and the company, unless minority shareholders have been given an independent valuation and have approved the transaction.

20. Are there restrictions on particular transactions between a company and its directors?

Other than the conflict rules (*see Question 19*), there are no restrictions on transactions between the director and the company. However, financial institutions are subject to more onerous restrictions on transactions with directors.

21. Are there restrictions on the purchase or sale by a director of the shares and other securities of the company he is a director of?

A director of a publicly traded company cannot purchase or sell shares and other securities of the company when he is in possession of undisclosed material information about the company.

DISCLOSURE OF INFORMATION

22. Do directors have to disclose information about the company to shareholders, the public or regulatory bodies?

Prospectuses offering securities to investors must be accurate and complete in all material respects. The prospectus must not misstate or omit material facts about the business or the financial condition of the company whose securities are being offered. Each director of a company issuing securities under a prospectus is personally liable to the investors for losses suffered if the prospectus misstates or omits a material fact.

The securities laws (*National Instrument 51-102 - Continuous Disclosure Obligations*) also require publicly traded companies to publicly file with the securities regulators financial and non-financial information throughout the year. Publicly traded companies must also issue a news release immediately after a material change has occurred in the company's business or affairs, and file a material change report as soon as possible and in any event within ten days. Although the company is responsible for complying with its continuous disclosure obligations, directors who authorise, permit or acquiesce in a breach of these obligations may be subject to enforcement proceedings (which could lead to sanctions, fines or imprisonment). Directors also face statutory civil liability to shareholders for breaches of these obligations.

COMPANY MEETINGS

23. Does a company have to hold an annual shareholders' meeting? If so, when? What issues must be discussed and approved?

Publicly traded companies must hold an annual shareholders' meeting no later than 15 months after the previous meeting and no later than six months after the company's year-end. At an annual meeting, the appointments of directors and the auditor are discussed and approved. The company's financial statements are also placed before the meeting.

Private companies often dispense with annual meetings by passing unanimous written resolutions that address these matters.

24. Can shareholders call a meeting or propose a specific resolution for a meeting? If so, what level of shareholding is required to do this?

Shareholders holding at least 5% of the company's voting shares can call a meeting or nominate directors to be included in the proxy circular for the annual meeting. To submit other proposals, shareholders must hold voting shares with either:

- At least 1% of the company's voting rights.
- A fair market value of at least Can$2,000.

MINORITY SHAREHOLDER ACTION

25. What action, if any, can a minority shareholder take if it believes the company is being mismanaged and what level of shareholding is required to do this?

Any minority shareholder can begin a proxy fight where it seeks the support of other shareholders in order to replace directors. A minority shareholder can also, at an annual meeting, nominate alternative directors from those nominated by management (irrespective of the shareholdings of the shareholder). A minority shareholder can also bring an action for breach of fiduciary duties or oppression (*see Question 15, General duties*).

INTERNAL CONTROLS, ACCOUNTS AND AUDIT

26. Are there any formal requirements or guidelines relating to the internal control of business risks?

Under the securities laws (*National Instrument 52-109 - Certification of Disclosure in Issuers' Annual and Interim Filings*), the CEO and CFO of publicly traded companies listed on the Toronto Stock Exchange must annually publicly certify their responsibility for establishing and maintaining disclosure controls and procedures and internal controls over financial reporting (ICFR).

Issuers must use a control framework to design their ICFR. The framework must be a suitable one that has been established using due process procedures, including the broad distribution of the framework for public comment. However, the Canadian regulators have not mandated the use of any particular control framework, although they have referred to the following frameworks that are commonly in use:

- Risk Management and Governance: Guidance on Control (COCO Framework), published by the Canadian Institute of Chartered Accountants.
- Internal Control-Integrated Framework (COSO Framework), published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).
- Guidance on Internal Control (Turnbull Guidance), published by the Institute of Chartered Accountants in England and Wales.

27. What are the responsibilities and potential liabilities of directors in relation to the company's accounts?

Companies must maintain proper books, records and accounts (*CBCA*). Directors can be held liable for breaches of their statutory fiduciary duties for failure to ensure that the requirement is satisfied. In addition, directors of publicly traded companies face statutory civil liability if the company issues financial statements that contain misrepresentations.

28. Do a company's accounts have to be audited?

Accounts of publicly traded companies must be audited. For private companies, shareholders can resolve to dispense with the requirement for an auditor.

29. How are the company's auditors appointed? Is there a limit on the length of their appointment?

In publicly traded companies the audit committee recommends the auditors for appointment. Auditors are appointed at the shareholders' annual meeting. They have one-year terms and their appointment lasts until the next annual meeting.

30. Are there restrictions on who can be the company's auditors?

Auditors must be registered with provincial regulatory bodies. Auditors must also be independent of the company they audit accounts for.

31. Are there restrictions on non-audit work that auditors can do for the company that they audit accounts for?

There are no restrictions on the non-audit work that auditors can do for the company. However, for publicly traded companies, approval of the audit committee for non-audit work is required.

32. What is the potential liability of auditors to the company, its shareholders and third parties if the audited accounts are inaccurate? Can their liability be limited or excluded?

Auditors face potential liability to the company and its shareholders (and possibly securities regulators) if the audited accounts are inaccurate. In particular, for publicly traded companies, auditors are subject to the statutory civil liability regime for disclosure violations in relation to their audit report. An auditor's liability is capped at the greater of either:

- Can$1 million.
- The revenue that the auditor earned from the issuer in the 12 months preceding the misrepresentation.

This does not apply to knowing violations, where there is no cap.

Auditors also normally attempt to limit their liability in their engagement letters with companies. However, the scope and effectiveness of this is not clearly established.

CORPORATE SOCIAL RESPONSIBILITY

33. Is it common for companies to report on social, environmental and ethical issues? Please highlight, where relevant, any legal requirements or non-binding guidance/best practice on corporate social responsibility.

Publicly traded companies must annually report on social or environmental policies that they have implemented and that are fundamental to their operations.

COMPANY SECRETARY

34. What is the role of the company secretary in corporate governance?

The company secretary is generally responsible for ensuring that:

- All director and shareholder meeting notice requirements are complied with (including the timing and provision of required information).
- Accurate minutes of the proceedings of meetings are recorded.
- Associated records are kept and maintained.

INSTITUTIONAL INVESTORS AND SHAREHOLDER GROUPS

35. How influential are institutional investors and other shareholder groups in monitoring and enforcing good corporate governance? Please list any such groups with significant influence in this area.

Institutional investors and other shareholder groups have become very influential in monitoring and enforcing good corporate governance. Institutional shareholders in Canada have followed their US counterparts by adopting and publishing proxy voting and corporate governance guidelines that focus, to a considerable extent, on corporate governance practices. These institutional shareholders include the:

- Canada Pension Plan Investment Board.
- Ontario Municipal Employees Retirement System.
- Ontario Teachers' Pension Plan Board.
- *Caisse de dépôt et placement du Québec*.

The Canadian Coalition for Good Governance, representing a significant number of Canadian institutional shareholders, also promotes best governance practices and the alignment of the interests of boards and management with those of the shareholders. The guidelines and standards of these institutions set out their policies and the manner in which the institution is likely to vote on them on a broad range of corporate governance and related issues, including:

- The composition of boards and board committees.
- Executive compensation.
- Takeover protection.
- Shareholder rights.
- Social responsibility.

Proxy service firms such as RiskMetrics (formerly Institutional Shareholder Services) are also active in Canadian public markets. Their voting recommendations on these issues can carry significant weight with their clients.

WHISTLEBLOWING

36. Is there statutory protection for whistleblowers (persons who disclose criminal activity or other serious malpractice within a company)?

It is an offence under the Criminal Code to attempt to prevent employees from giving information to law enforcement personnel about suspected unlawful corporate conduct, or to retaliate against employees if they have done so.

REFORM

37. Please summarise any proposals for reform and state whether they are likely to come into force and, if so, when.

The Ontario Securities Commission is considering regulatory changes to enhance shareholder democracy at public companies. It is considering issues relating to slate voting and majority voting in relation to director elections, the effectiveness of the proxy voting system and shareholder advisory votes on executive compensation. No specific proposed rules or policies have yet been published.

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Areas of practice. M&A; corporate governance; and securities.

Recent transactions

- Advising TMX Group in its proposed 2011 US$6.9 billion merger with London Stock Exchange Group.
- Advised Canada Development Investment Corporation (through Canada GEN Investment Corporation) as a selling shareholder in General Motors' initial public offering.
- Advised Canada Post on its aggregate Can$1billion long-term debt issue, to finance the company's postal modernisation programme.