

2014

A Canadian Model of Corporate Governance: Where Do Shareholders Really Stand?

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Citation Details

Carol Liao, "A Canadian Model of Corporate Governance: Where Do Shareholders Really Stand?" (January/February 2014) Director J. Institute of Corporate Directors 36-38.

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A Canadian Model of Corporate Governance

Where do shareholders really stand?

Insights from leading practitioners reveal conflicting opinions.

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CANADIAN DIRECTORS are inundated with U.S. corporate governance research, leading many directors to assume Canadian and American governance fundamentals are one and the same. But in fact, there are important differences found in Canadian governance. These differences are often recognized by high-end corporate lawyers but probably not anywhere else, to Canada's detriment.

In a study sponsored by the Canadian Foundation for Governance Research, I interviewed 32 leading senior legal practitioners to gain their insights on the underlying principles that form a 'Canadian' model of governance.¹ The candid observations from these practitioners, who provided comments on a not-for-attribution basis, reveal a



surprising legal and regulatory landscape in Canada.

Building Blocks of Canadian Corporate Law

"Shareholders do not have primacy in the corporate context in Canada, although directors generally think that they do," observed one practitioner. "It is a very difficult distinction that the Canadian courts have made, based upon our corporate statutes, and it is a very difficult distinction to explain to boards of directors."

Some of these distinctions include the fact that Canadian legislation requires directors to act in the "best interests of the corporation" as opposed to the "best interests of the shareholders."² Canada is also fairly unique in its oppression remedy,

1 My thanks to the following senior legal practitioners who generously contributed their time and expertise to the study: William M. Ainley, Davies Ward Phillips & Vineberg LLP; Rita C. Andreone, Q.C., Lawson Lundell LLP; Jeff Barnes, Borden Ladner Gervais LLP; Noralee Bradley, Osler, Hoskin & Harcourt LLP; William J. Braithwaite, Stikeman Elliott LLP; Terrence Burgoyne, Osler, Hoskin & Harcourt LLP; Rob Collins, Blake, Cassels & Graydon LLP; Douglas G. Copland, Borden Ladner Gervais LLP; Dallas L. Droppo, Blake, Cassels & Graydon LLP; Aaron S. Emes, Torys LLP; Jean Fraser, Osler, Hoskin & Harcourt LLP; Sharon C. Geraghty, Torys LLP; Mitchell H. Gropper, Q.C., Farris, Vaughan, Wills & Murphy LLP; Stephen Halperin, Goodmans LLP; Carol Hansell, Hansell LLP; Doug H. Hopkins, Boughton Law Corporation; Michael L. Lee, Lawson Lundell LLP; Robert Lehodey, Q.C., Osler, Hoskin & Harcourt LLP; Jon Levin, Fasken Martineau DuMoulin LLP; Andrew J. MacDougall, Osler, Hoskin & Harcourt LLP; R. Hector MacKay-Dunn, Q.C., Farris, Vaughan, Wills & Murphy LLP; Margaret C. McNee, McMillan LLP; D. Shawn McReynolds, Davies Ward Phillips & Vineberg LLP; William K. Orr, Fasken Martineau DuMoulin LLP; Barry J. Reiter, Bennett Jones LLP; Simon A. Romano, Stikeman Elliott LLP; Richard A. Shaw, Q.C., ICD.D., Richard A. Shaw Professional Corp.; John Smith, Lawson Lundell LLP; Rene R. Sorell, McCarthy Tétrault LLP; Tom Theodorakis, McMillan LLP; Edward J. Waitzer, Stikeman Elliott LLP; and Marvin Yontef, Bennett Jones LLP. It should be noted that participants spoke for themselves and not necessarily for the organizations with which they are affiliated. Their participation should not be construed as an endorsement of the findings highlighted in this article.

2 There was disagreement among the practitioners as to whether or not this was a meaningful difference in practice.

“ Whether by choice or through the process of elimination, the securities commissions are now playing a major role in shaping Canadian corporate governance practices. ”

which provides a broader right of action for minority shareholders and other non-shareholder stakeholders.³ Landmark decisions by the Supreme Court of Canada have emphasized these statutory differences,⁴ causing many practitioners to inform boards that they can – and indeed should – take into account non-shareholder value issues. Stakeholder interests may have always had a role in governance under Canadian statutory laws, but the courts have now generated a need for boards to document their process of considering those interests.

Despite the fact that Canadian statutes and common law have tended to favour a more stakeholder-friendly model that assumes greater board control, the legislators and the courts have not proven to be significant leaders in the development of corporate governance standards. Eliciting legislative change is an extremely slow progression and corporate legislation operates on a jurisdictional basis. Substantial corporate cases in Canada are also few and far between, and along with the business judgment rule,⁵ Canadian courts simply do not have the instrumentalities to promote good governance standards.

Power and Influence of Securities Regulators

Whether by choice or through the process of elimination, the securities commissions are now playing a major role in shaping Canadian corporate governance practices. By virtue of the fact that the securities commissions have a public interest jurisdiction to protect the capital markets,⁶ and by design are investor-focused, their influence has pushed Canada toward a more shareholder-centric model of governance. Securities regulators have increased shareholders' rights well beyond what has ever been contemplated under Canadian corporate law.

Many of the surveyed practitioners found it a curious Canadian phenomenon that the securities regulators are significantly affecting the corporate legal sphere. Practitioners recounted how over a decade ago when the securities regulators initially began encroaching on a space that was traditionally for the legislatures and the courts, it was extraordinarily controversial. Now, people seem to have moved past the notion that the securities commissions are overstepping their jurisdiction and have generally accepted the regulators' role in shap-

ing Canadian corporate governance. Since the Canadian Securities Administrators (CSA) are able to act on a coordinated basis across the nation, the organization has become a very convenient place to deal with change. Institutional investors deliberately seek out the CSA to enhance shareholder rights, even if, from a philosophical perspective, corporate legislation is the more appropriate venue.

Practitioners cited some notable disadvantages to having the regulators dominate corporate governance in Canada. Several pointed to the fact that the commissions have often disregarded findings from the courts, are not well-versed in evidentiary rules, and often fail to establish principles that can guide lower courts. A few felt that there was no need for securities regulators to interfere with the carefully engineered corporate structure, with one practitioner voicing the common sentiment that “what’s in the best interest of the shareholder doesn’t align with better governance – that’s where [the practice] falls down.”

Current Debate on Shareholder Rights Plans

Canada is considered a very bidder-friendly jurisdiction. National Policy 62-202 *Take-Over Bids – Defensive Tactics* leaves Canadian boards with a limited number of defenses when faced with an unsolicited takeover bid.⁷ This position is now under review in Canada. The CSA has released proposed National Instrument 62-105 *Security Holders Rights Plans* (NI 62-105), which would allow target boards

3 S. 241 of the *Canada Business Corporations Act*, R.S.C., 1985, c. C-44.

4 Specifically, *Peoples Department Stores Inc (Trustee of) v Wise*, 2004 SCC 68 and *BCE Inc v 1976 Debentureholders*, 2008 SCC 69.

5 The business judgment rule means that courts will defer to the directors' business judgment so long as those directors used an appropriate degree of prudence and diligence in reaching a reasonable business decision at the particular time the decision was made. See *Peoples*, *supra* note 4 at paras 64-65.

6 S. 127(1), para 3 of the *Securities Act*, R.S.O. 1990, c. S-5.

7 National Policy 62-202 *Take-Over Bids – Defensive Tactics*, online: Ontario Securities Commission <www.osc.gov.on.ca/en/13274.htm>.

to implement shareholder rights plans (known as “poison pills”)⁸ for a longer period than currently permitted when facing a hostile bid, subject to shareholder approval.⁹ An alternative proposal has been put forth by the Autorité des marchés financiers (AMF), the organization mandated by the Quebec government to regulate Quebec’s financial markets.¹⁰ The AMF proposal seeks a new regime to govern all defensive measures, allowing boards a greater overall arsenal to defend target companies in the face of unwanted takeover bids. The extended comment period for these proposals closed in July 2013.

As one practitioner observed:

The proposals can be seen as a subtext of who actually should have ultimate decision-making authority in the context of change of control transactions: whether it should be the shareholders, which is the current approach of the securities regulatory scheme and the approach the commissions have traditionally taken on poison pills, or whether the boards should be more empowered, which is the path the courts seem to have taken but the regulators have not.

An overwhelming majority of the practitioners did not support the trend of greater shareholder control, and preferred the AMF proposal. Interestingly, the priorities of the regulators and these practitioners are very much aligned: getting the highest value for shareholders. But while the regulators have tended towards increasing shareholder rights in order to accomplish that goal, the practitioners in the study felt that action is misplaced.

They contend that directors are in the best position to unlock share value, as it is their fiduciary duty to act in the best interests of the corporation, but directors are being denied the proper tools to do so.

The practitioners’ concerns tended to focus on how the regulators have elected to protect shareholder value. They argued it should not be done through shareholder approvals, but through greater powers bestowed on the board to exercise their duties to the corporation.

If indeed the AMF proposal is taken to be the position by securities commissions across Canada, which some practitioners predicted as unlikely, that would be a significant step away from how Canadian governance is currently forming in the M&A context. Indeed, as one practitioner put it, “the shareholder primacy model has different ingredients to it,” meaning “there are some elements that are stronger than in others,” and most importantly, “the sands on this can shift.”

Toward a Canadian Model

Practitioners’ views on an overall Canadian model seemed to depend in large part on what each practitioner found most compelling: the constancy of the corporate statutes and trajectory of the common law, or the power and influence held by the regulators.

The conflicting theoretical positions from the courts and the securities commissions have enriched the dialogue on the current environment of Canadian corporate governance. While most practitioners felt that Canadian gover-

nance norms and culture are becoming quite well-developed, the frequent pull in different directions from the regulators and influential power sources in Canada have left Canadian governance in a “period of uncertainty – we’re still trying to figure out what the model should be.”

The common law has made the process of considering stakeholders in the best interests of the corporation more overt, well beyond what is assumed in Anglo-American corporate legal scholarship. Layered onto this corporate legal base, the securities commissions have provided other measures to bolster the field of corporate governance in Canada, while seeking to protect the integrity of the capital markets and the interests of investors within those markets. It remains to be seen – from the pending determinations regarding the CSA’s proposed NI 62-105 and the AMF proposal – whether the regulators will be tempering their positions toward shareholder primacy in the future.

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The complete study, “A Canadian Model of Corporate Governance: Insights from Canada’s Leading Legal Practitioners,” is available online at the Canadian Foundation for Governance Research: www.cfgr.com

8 A shareholder rights plan is a defensive tactic employed by companies to discourage hostile takeovers. This is done by making the shares of a company less attractive to the potential acquirer, either by allowing existing shareholders to buy more shares at a discount, or allowing shareholders to buy the acquirer’s shares at a discounted price after the merger.

9 Canadian Securities Administrators, “Notice and Request for Comment: Proposed National Instrument 62-105 Security Holders Rights Plans, Proposed Companion Policy 62-105CP, and Proposed Consequential Amendments” (14 March 2013), online: <www.osc.gov.on.ca>.

10 Autorité des marchés financiers, “Consultation Paper: An Alternative Approach to Securities Regulators’ Intervention in Defensive Tactics” (14 March 2013), online: Autorité des marchés financiers <www.lautorite.qc.ca>.