GETTING THE DEAL THROUGH

Corporate Governance

Board structures and directors' duties in 39 jurisdictions worldwide

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Sources of corporate governance rules and practices

1 What are the primary sources of law, regulation or practice relating to corporate governance?

The corporate governance of Canadian public companies is regulated by corporate laws, securities laws and the rules of the stock exchanges on which they are listed.

Canadian public companies may be incorporated under the federal Canada Business Corporations Act (CBCA) or one of the similar provincial or territorial corporate statutes. These statutes regulate ordinary and extraordinary corporate transactions and establish minimum corporate governance requirements and standards.

Securities regulation is the responsibility of the provinces and territories, which have their own legislation and securities regulatory authorities. The provincial and territorial securities regulatory authorities coordinate their activities through the Canadian Securities Administrators (CSA), a forum for developing a harmonised approach to securities regulation across the country. The CSA has developed a system of mutual reliance pursuant to which one securities regulatory authority acts as the lead authority for dealing with a particular public company.

There are two principal stock exchanges in Canada: the Toronto Stock Exchange (TSX), the senior market, and the TSX Venture Exchange, the junior market.

The Canadian approach to corporate governance is influenced by:

- the relatively small size of the Canadian capital markets;
- the large number of small-cap Canadian public companies (there are almost one-and-a-half times as many companies listed on the TSX Venture Exchange as on the TSX);
- the concentration of share ownership (many of the 300 largest Canadian public companies listed on the TSX have a controlling shareholder, and even more of them have a significant shareholder);
- the fact that many Canadian public companies are interlisted on Canadian and US stock exchanges; and
- the privileged access that eligible Canadian public companies have to the US capital markets.

Many Canadian public companies may take advantage of the Canada–US Multi-Jurisdictional Disclosure System, a regime that allows them to access the US public markets using Canadian disclosure documents (which are subject to review by Canadian securities regulatory authorities only) without becoming subject to US domestic registration and reporting requirements. In many cases, Canadian continuous reporting documents can also be used to satisfy US obligations for continuous reporting.

The CSA has established several national instruments and policies (CSA Rules) that affect the corporate governance of Canadian public companies. The CSA Rules are similar to the US Sarbanes-Oxley Act and the consequential rules and guidelines established by the US Securities and Exchange Commission (SEC) and US stock exchanges. The CSA Rules deal with:

- oversight of external auditors, including pre-approval of audit and non-audit services, prohibited services and audit partner and audit review partner rotation and cooling off periods for hiring employees of external auditors;
- chief executive officer (CEO) and chief financial officer (CFO) certification with respect to the accuracy of public disclosure and filings (eg, interim and annual financial statements and related management discussion and analysis), disclosure controls and procedures and internal control over financial reporting;
- the composition, authority and responsibilities of audit committees; and
- continuous disclosure obligations, including disclosure of whether companies have adopted the non-prescriptive corporate governance best practices recommended by the CSA and, if not, how their practices nonetheless meet the objectives of the recommended best practices. Public companies listed on the TSX Venture Exchange are exempt from some of the CSA Rules.

2 What are the primary government agencies or other entities responsible for making such rules and enforcing them? Are there any well-known shareholder activist groups whose views are often considered?

Generally, Canadian corporate laws are enforced by private parties through the courts. Securities regulatory authorities have enforcement powers and staff dedicated to the enforcement of securities laws. They are, however, limited in the sanctions that they may impose – administrative fines of up to C$5 million, cease-trading orders, disgorgement of improper gains and prohibition on further participation in the capital markets – and must look to the courts to impose other sanctions (eg, higher fines and jail terms). Stock exchanges impose conditions of listing and continued listing and have the power to delist companies for non-compliance with stock exchange rules.

Institutional investors are active in corporate governance matters and have demonstrated a willingness to use the courts and securities regulatory authorities to challenge board decisions and processes. Some of Canada's largest institutional shareholders (including the Ontario Teachers' Pension Plan System, the Ontario Municipal Employees Retirement System, Canada Pension Plan Investment Board and Caisse de dépôt et placement

du Québec) publish proxy voting guidelines setting out how they intend to vote in respect of certain corporate governance matters. In addition, the Canadian Coalition for Good Governance (which includes Canada's largest pension and mutual funds and money managers) has released Corporate Governance Guidelines for Building High Performance Boards that are intended to improve the accountability of individual directors and board structures and processes. Other organisations active in the area of corporate governance include the Institute of Corporate Directors, the Canadian Institute of Chartered Accountants and Institutional Shareholder Services (ISS) (which provides corporate governance research and related services to institutional investors).

The rights and equitable treatment of shareholders

3 What powers do shareholders have to appoint or remove directors or require the board to pursue a particular course of action?

Shareholders elect the directors of Canadian public companies. The directors, not the shareholders, have the responsibility to manage, or supervise the management of, the business and affairs of the company. Shareholders have the power to remove directors.

The management of Canadian public companies normally nominates director candidates (on the recommendation of the board of directors and, where applicable, the board nominating committee). Shareholders holding at least 5 per cent of the shares of a company may nominate director candidates before the annual meeting of shareholders at which directors are elected. Any shareholder may nominate director candidates at the meeting. Because management controls the solicitation of proxies for meetings of shareholders, management's nominees are usually elected. Proxy battles are unusual.

4 What decisions are required to be reserved to the shareholders?

Canadian corporate statutes regulate ordinary and extraordinary corporate transactions. Ordinary transactions require majority shareholder approval (over one-half of the votes cast). Extraordinary corporate transactions (eg, statutory amalgamations, plans of arrangement, the sale, lease or exchange of all or substantially all of the property of a company, liquidation and dissolution) require special shareholder approval (typically, at least two-thirds of the votes cast). Most corporate statutes give shareholders the right to dissent with respect to extraordinary corporate transactions and demand fair value for the shares held by them.

The provinces of Ontario and Québec have securities rules (including approval by a majority of the minority shareholders and independent valuation of the subject matter of a transaction) designed to ensure fair treatment of minority shareholders in connection with certain types of transactions involving related parties (which include the holders of 10 per cent or more of the voting securities of a company).

The TSX also requires shareholder approval of certain stock based compensation arrangements and transactions involving the issuance of shares which may materially affect control of a company (generally, a transaction that results, or could result, in a new holding of more than 20 per cent of the voting shares by one shareholder or a combination of shareholders acting together will be considered to materially affect control unless the circumstances indicate otherwise).

5 To what extent are disproportionate voting rights or limits on the exercise of voting rights allowed?

Generally, shareholders are entitled to one vote per share. There is, however, no prohibition on the creation and issuance of classes of shares with different voting rights and it is not uncommon for Canadian public companies (particularly family-controlled companies and companies operating in sectors with foreign ownership restrictions) to have restricted shares (equity shares that have lesser voting rights than other classes of voting shares). Securities laws and stock exchange listing requirements may require shareholder approval for the issue of restricted shares, stipulate what restricted shares may be called and impose disclosure requirements. The TSX rules require that the articles of a listed company with restricted shares include 'coat-tail' rights in the event of a takeover bid.

6 Are there any special requirements for shareholders to participate in general meetings of shareholders or to vote?

Canadian public companies must hold an annual meeting of shareholders within six months after their year-end and not later than 15 months after the last annual meeting to elect directors and to appoint auditors and authorise their remuneration. They are also required to hold a special meeting of shareholders to approve other ordinary and extraordinary corporate transactions.

Shareholders entitled to vote at a meeting are entitled to receive notice of the meeting, a management information circular describing the business to be transacted at the meeting and other prescribed information and a proxy for use in connection with the meeting. Companies typically propose that one or more members of management act as proxy holders at the meeting but shareholders have the right to appoint other persons (who need not be shareholders).

Except as may be set out in a company's governing documents, a quorum for a meeting is shareholders holding at least a majority of the outstanding shares present in person or by proxy. Typically, however, the governing documents provide for a reduced quorum, some as low as two shareholders present in person or represented by proxy.

7 Are shareholders able to require meetings of shareholders to be convened, resolutions to be put to shareholders against the wishes of the board or the board to circulate statements by dissident shareholders?

Shareholders who hold at least 5 per cent of the voting shares may require that a meeting of shareholders be called and held for the purposes stated in the request. Subject to certain procedural rules, a shareholder may request that a shareholder proposal be included in the agenda of a meeting of shareholders and voted on at the meeting.

8 Do controlling shareholders owe duties to the company or to non-controlling shareholders? If so, can an enforcement action against controlling shareholders for breach of these duties be brought?

Shareholders, including controlling shareholders, do not owe fiduciary duties to the company or other shareholders. Certain transactions involving the company and related parties (which include the holders of 10 per cent or more of the voting securities of a company) may, however, be subject to enhanced fairness rules (see question 4).

9 Can shareholders ever be held responsible for the acts or omissions of the company?

Generally, shareholders are not responsible for acts or omissions of the company.

Corporate control

10 Are anti-takeover devices permitted?

Anti-takeover or defensive devices are permitted if they are in the best interests of shareholders (determined by the board of directors).

The adoption or use of a shareholder rights plan (sometimes referred to as a 'poison pill') to delay completion of a hostile takeover bid is the most common anti-takeover or defensive device used in Canada. A target's poison pill will usually be triggered when a person acquires or announces its intention to acquire a specified percentage (typically 20 per cent) of the securities of the target and may cause a significant dilution of the acquirer's voting rights and economic interest unless a permitted bid is made. Canadian securities regulators will not permit a poison pill to be used to deny shareholders the opportunity to make their own decision with respect to a bid and will terminate a poison pill if the target is unable to demonstrate that it is actively pursuing alternative transactions or if there seem to be no prospective alternative bids. If a shareholder rights plan is adopted by the board without shareholder approval, the TSX rules require that shareholders approve the plan within six months of its adoption.

Other anti-takeover or defensive devices, such as 'shark repellents', are not popular and staggered boards are not common.

11 Are restrictions on the transfer of fully paid shares permitted, and if so, what restrictions are commonly adopted?

Generally, Canadian public companies do not have restrictions on the transfer of their shares. Some companies which operate in industries with foreign ownership limits or ownership concentration restrictions may, however, have limits or restrictions on the issue, transfer or ownership of their shares.

12 Are compulsory share repurchase rules allowed? Can they be made mandatory in certain circumstances?

Companies may issue securities that may be repurchased at the option of the holder or the company either at specified times or upon the occurrence of certain events (eg, change of control). The securities must provide for the terms and mechanics of the repurchase and the company must satisfy certain solvency tests before it can complete a repurchase.

Subject to certain procedural restrictions, an acquirer who acquires at least two-thirds of the shares of a Canadian public company pursuant to a takeover bid may compulsorily acquire the balance of the shares at the takeover bid price. Shareholders who dissent from the compulsory acquisition are entitled to receive fair value.

The responsibilities of the board (supervisory)

13 Is the predominant board structure for listed companies best categorised as one-tier or two-tier?

The predominant board structure for Canadian public companies is one-tier. Members of management may serve on the board but they are not organised as a separate management board.

14 What are the board's primary legal responsibilities?

Under Canadian corporate statutes, the responsibility of the board of directors of a company is to manage, or supervise the management of, the business and affairs of the company. The CSA Rules list the following as the board's main areas of responsibility:

- adopting a strategic planning process and approving, on at least an annual basis, a strategic plan which takes into account, among other things, the opportunities and risks of the business;
- developing the company's internal control and management information systems;
- identifying the principal risks of the company's business, and ensuring the implementation of appropriate systems to manage these risks;
- adopting a communication policy for the company;
- developing the company's approach to corporate governance, including developing a set of corporate governance principles and guidelines that are specifically applicable to the company;
- succession planning (including appointing, training and monitoring senior management); and
- to the extent feasible, satisfying itself as to the integrity of the CEO and other executive officers of the company and that the CEO and other executive officers create a culture of integrity throughout the organisation.

15 Whom does the board represent and to whom does it owe legal duties?

Directors of Canadian public companies owe fiduciary duties of loyalty and care to the company. Canadian courts have interpreted this duty as meaning directors must act in the best interests of the shareholders unless there is or may be nothing left for the shareholders (eg, upon an insolvency), in which case they have a duty of care to those who have a prior claim on the assets of the company (eg, the creditors). In recent years, there have been attempts to extend the duty of directors to a broader group of stakeholders (eg, employees and communities in which they are located). To date, these attempts have not had any tangible legal results, either in corporate statutes or before the courts. Generally, Canadian public companies are aware of the need to act, and the benefits of acting, responsibly in their dealings with governments, their employees and the communities in which they operate. Many of these concepts are included in codes of ethics and conduct adopted by larger Canadian public companies and recommended under the CSA Rules.

16 Can an enforcement action against directors be brought on behalf of those to whom duties are owed?

Canadian courts have broad remedial powers under Canadian corporate statutes to intervene in transactions that are oppressive or unfairly prejudicial to shareholders or that unfairly disregard the interests of shareholders. They also have broad powers to permit shareholders to commence a derivative action on behalf of a Canadian public company or intervene in an action involving a Canadian public company for the purpose of prosecuting, defending or discontinuing the action on behalf of the company.

17 Do the board's duties include a care or prudence element?

The directors' duties of loyalty and care require that they act honestly and in good faith for the best interests of the shareholders and exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

18 To what extent do the duties of individual members of the board differ?

The answer to the question is unclear. In theory, the requirement that directors exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances is an objective test independent of the skills and experience of each director. In practice, it is difficult to see how the courts could ignore the skills and experience of a director when considering whether that director, and indeed the board as a whole, has satisfied this requirement.

19 To what extent can the board delegate responsibilities to management, a board committee or person?

Boards are responsible for supervising the management of the business and affairs of Canadian public companies. The officers (management) are responsible for day-to-day management. Typically, Canadian public companies have a CEO (usually the president), a CFO, one or more vice presidents in charge of various company businesses or functions and a secretary (often combined with the office of general counsel).

Boards of Canadian public companies normally use focused committees (including audit, corporate governance and compensation committees and ad hoc committees) as an effective way of discharging their duties.

Canadian corporate statutes prohibit the board from delegating certain matters, including issuing securities, declaring dividends, purchasing or acquiring securities of the company, approving annual audited financial statements, approving a management proxy circular, takeover bid circular or directors circular and adopting, amending or repealing by-laws.

20 Is there a minimum number of 'non-executive' or 'independent' directors required by law, regulation, or listing requirement? If so, what is the definition of 'non-executive' and 'independent directors' and how do their responsibilities differ from executive directors?

Canadian corporate statutes require the board of a Canadian public company to have a minimum number of non-executive directors. Many also require the board to have a minimum number of resident Canadian directors (eg, 25 per cent under the CBCA). A 'non-executive' director is a director who is not an officer or employee of the company. A 'resident Canadian' director is a director who is a Canadian citizen ordinarily resident in Canada or, if not ordinarily resident, a member of a prescribed class (eg, employees of Canadian governments or companies serving abroad) or a foreign citizen who has Canadian permanent residence status, is ordinarily resident in Canada and has not been eligible to apply for Canadian citizenship for more than one year.

Canadian public companies listed on the TSX are required to have a board composed of at least three independent directors to satisfy corporate and securities law requirements for an audit committee composed of at least three directors, all of whom are independent. The CSA Rules recommend that a majority of directors be independent, but this is not required. An 'independent director' is a director who has had no direct or indirect material relationship with the company or its subsidiaries within prescribed periods (generally, three years). A 'material' relationship is a relationship that could, in the view of the board, be reasonably expected to interfere with the exercise of a director's independent judgement or his or her ability to act in the best interests of the company. The CSA Rules also contain bright line tests for determining whether a material relationship exists in certain circumstances.

21 Do law, regulation, listing rules or practice require separation (or joining) of the functions of board chairman and CEO? If flexibility on board leadership is allowed by law, regulation and listing rule, what is generally recognised as best practice and what is the common practice?

The CEO of a Canadian public company may also act as board chair. The CSA Rules recommend that the chair of the board be an independent director or, where this is not appropriate, an independent director be appointed to act as lead director. In either case, an independent director should act as the effective leader of the board and ensure that the board's agenda will enable it to successfully carry out its duties.

22 What board committees are mandatory? What board committees are allowed? Are there mandatory requirements for committee composition?

Canadian corporate statutes require that boards of Canadian public companies have an audit committee consisting of at least three directors.

The CSA Rules require that Canadian public companies have an audit committee composed of at least three directors, all of whom are independent and financially literate, and an audit committee charter giving the audit committee responsibility for, among other things:

- appointing the external auditors and setting their compensation (subject to shareholder approval);
- overseeing the work of the external auditors, including the resolution of disagreements between management and the external auditors;
- pre-approving audit and non-audit services;
- reviewing all public disclosure of financial information; and
- establishing procedures for dealing with complaints with respect to accounting or auditing matters and for whistle-blowing.

A director is considered 'financially literate' if he or she has the ability to read and understand a set of financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the accounting issues that can reasonably be expected to be

raised by the financial statements of the company.

The CSA Rules also recommend that Canadian public companies have compensation and nominating committees composed entirely of independent directors.

23 Is a minimum or set number of board meetings per year required by law, regulation or listing requirement?

There is no minimum prescribed by law. In practice, boards of Canadian public companies must meet at least four or five times a year to satisfy their disclosure and supervisory obligations. Except as may be set out in the corporate statutes and the company's governing documents, boards are free to establish their own operating procedures. Typically, the board chair or lead director (as applicable) and the CEO establish the agenda for a board meeting, with input from other directors and senior management. The agenda together with supporting material is typically sent to the directors well in advance of the meeting. The board chair or lead director (as applicable) usually presides at board meetings. Typically, the independent directors meet for part of the meeting without management present.

24 Is disclosure of board practices required by law, regulation or listing requirement?

The CSA Rules require Canadian public companies to include in their annual management information circular a corporate governance report in a prescribed form describing their corporate governance practices. The report must include disclosure of whether the company has adopted the non-prescriptive best practices recommended by the CSA and, if not, how the company's practices meet the objectives of the recommended practices. The non-prescriptive best practices recommended by the CSA include:

- having a majority of independent directors;
- appointing a chair who is an independent director or, where this is not possible, a lead director who is independent;
- adopting a charter setting out the responsibilities and operating procedures of the board of directors;
- adopting a written code of business conduct and ethics; and
- establishing nominating and compensation committees composed entirely of independent directors and adopting charters for such committees.

See also question 31.

25 Is there any law, regulation, listing requirement or practice which affects the remuneration of directors, the length of directors' service contracts, loans to directors or other transactions between the company and any director?

There are disclosure requirements relating to director remuneration and other contracts (including loan arrangements). Canadian public companies that are listed on US stock exchanges are prohibited under US securities laws from providing loans and other financial assistance to directors.

26 How is the remuneration of the most senior management determined? Is there any law, regulation, listing requirement or practice which affects the remuneration of senior managers, loans to senior managers or other transactions between the company and senior managers?

Generally, the board on the recommendation of the compensation committee determines the remuneration of the CEO and the CEO determines the remuneration of other senior management, subject to the oversight of the board and the compensation committee. Canadian public companies that are listed on US stock exchanges are prohibited under US securities laws from providing loans and other financial assistance to senior management.

See also question 31.

27 In relation to directors and officers liability insurance: is it permitted or common practice; can the company pay the premiums?

It is permitted and common practice for a company to obtain and pay for directors and officers liability insurance.

28 Are there any constraints on the company indemnifying directors in respect of liabilities incurred in their capacity as directors? If not, are such indemnities common?

Canadian corporate statutes permit Canadian public companies to provide a broad indemnity to their directors. Such indemnities are typically limited to situations where the director has acted honestly and in good faith with a view to the best interests of the company and with the reasonable belief that his or her actions were legal. Such indemnities are common.

29 What role do employees play in corporate governance?

There is no formal role for employees in the corporate governance process except to the extent that they are shareholders, directors or officers of the company or whistleblowers.

Disclosure and transparency

30 Are the corporate charter (or articles of incorporation) and by-laws of companies publicly available? If so, where?

The governing documents (ie, the articles and by-laws) of Canadian public companies are public information.

31 What information are companies required to publicly disclose? How often is such disclosure required to be made?

Canadian public companies are required to prepare, publicly disclose and file with the securities regulatory authorities interim quarterly unaudited and annual audited financial statements and related management discussion and analysis. They are also required to prepare and file with the securities regulatory authorities an annual continuous disclosure document (the annual information form or AIF) setting out all material information with respect to the company.

Canadian public companies are also required to prepare a management information circular in connection with the annual meeting of shareholders. In addition to information with respect to the business to be transacted at the meeting, the circular must include prescribed information with respect to:

- compliance with corporate governance best practices;
- shareholdings of directors and significant shareholders; and

- director and senior officer compensation (salary and share-based) and indebtedness, including a report of the board or the compensation committee on executive compensation.

Other information may also be provided, such as a summary of the board and committee meetings held and a record of attendance by directors.

Canadian public companies are required to make immediate public disclosure, followed by a filing with the securities regulatory authorities, of any material change in the business, operations or capital of the company (ie, any change that would reasonably be expected to have a significant effect on the market price or value of the securities of the company).

Finally, insiders (ie, directors, senior officers and shareholders owning 10 per cent or more of the voting securities) of a company are required to disclose changes in their share ownership.

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