ONTARIO COURT OF APPEAL INTERPRETS THE TSX'S MAJORITY VOTING REQUIREMENT, CONSIDERS THE OPPRESSION REMEDY, AND CLARIFIES SET-OFF RIGHTS

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A recent decision of the Ontario Court of Appeal interprets the Toronto Stock Exchange ("**TSX**") requirement that listed companies adopt a majority voting policy for director elections. In *Baylin Technologies Inc. v. Gelerman*,[1] the Court overturned the application judge and held unanimously that when a majority voting policy is adopted, "withheld" votes during director elections are considered votes "against". The decision also reminds claimants that proving a claim for oppression requires, among other things, that the complainant's reasonable expectations be established against an objective standard. Finally, the Court confirms that undelivered share certificates can be subject to a claim for contractual set-off even where no claim for legal or equitable set-off could be made out.

Background

Baylin Technologies Inc. ("**Baylin**") acquired various assets from Spacebridge Inc. ("**Spacebridge**") further to an asset purchase agreement ("**APA**"). As part of the APA, Baylin agreed to nominate the founder of Spacebridge, David Gelerman ("**Gelerman**"), for election to its board at the company's next two annual general meetings, and to assist him in gaining the requisite votes for election. Baylin also agreed to pay Spacebridge $2.5 million in installments over two years for the consulting services of Gelerman and his wife under a consulting agreement. Half of this amount was to be paid quarterly in shares of Baylin, while the other half was to be paid in cash.

Following the acquisition of Spacebridge, Baylin completed another transaction that left it with insufficient interest to ensure Gelerman's re-election to its board. Moreover, as a result of that transaction, Baylin had an obligation to implement a policy for its majority voting requirements in accordance with Section 461.3 of the TSX Company Manual. Subject to exceptions, that section requires listed issuers without a majority shareholder to adopt and disclose annually their voting policy for the election of directors.

TSX Majority Voting Requirement

To maintain a listing on the TSX, a listed issuer must adopt a majority voting policy providing, among other things, that if a director is not elected by a majority (at least 50% + 1) of the total votes cast in an uncontested election, they must immediately tender their resignation.[2] Because corporate legislation does not currently allow shareholders to vote against a candidate for election, this policy provides shareholders with greater authority to elect directors by requiring them to receive a majority of votes. Without this policy, a director with a single vote "for" could be elected to the Board even where the majority of shareholders withheld their votes.

The policy must also indicate that the company is required to accept the resignation absent "exceptional circumstances" that merit the director continuing to serve on the Board. The TSX offers guidance on what and "exceptional circumstance" might entail, explaining that the threshold for a board of directors to refuse to accept a director's resignation is high and evaluated on a case-by-case basis, taking into account unique factors specific to each company. An example provided by the TSX that could meet this threshold includes where a director's departure would cause the company to be non-compliant with applicable laws, regulations or "commercial agreements" regarding the Board's composition.[3]

Baylin's majority voting policy (the "**Policy**") explicitly provided that where a director receives more 'withheld' votes than votes 'in favour' of their appointment, they must submit their resignation to the Board. The Policy also specified three "exceptional circumstances" in which it would consider allowing a director to continue to serve on the Board, even absent a majority of votes. Baylin did not expressly include non-compliance of a commercial agreement as a circumstance authorizing the Board to reject a director's resignation as contemplated in the TSX's guidance. The terms of the Policy were unanimously approved by Baylin's Board, which included Gelerman.

Leading up to the 2019 AGM, friction developed between Gelerman and Baylin's Board Chairman, who was also the sole director and officer of Baylin's largest shareholder, 2385769 Ontario Inc. ("**2385769**"). In accordance with its obligations under the APA, Baylin notified Gelerman that it would nominate him for election at the AGM, but that 2385769 did not intend to support his re-election. Baylin also advised Gelerman that without 2385769's support, Gelerman would not likely be re-elected. At the AGM, Gelerman only received 29% of the eligible votes for his re-election, but refused to resign.

Further to the Policy, Baylin sought Gelerman's resignation. Gelerman argued that Baylin acted oppressively in formulating the Policy to have him removed as a director such that his resignation was not required.

The application judge agreed with Gelerman. He set aside the Policy on the grounds that it failed to comply with TSX requirements. The application judge also found that Baylin's Policy wrongfully focused on withheld votes rather than on votes cast, maintaining that withheld votes should not be considered as a vote against. Moreover, he concluded that while the TSX does not limit what may constitute exceptional circumstances,

Baylin improperly departed from the examples in TSX's notice by omitting non-compliances with commercial agreements.

At the Court of Appeal, Justice Nordheimer held that under the TSX requirements, any withheld votes are to be counted as votes against a director. Furthermore, the TSX requirements do not restrict businesses from stipulating in advance what will constitute exceptional circumstances. The examples provided by the TSX were not prescribed requirements that businesses must follow but merely a guide for businesses in drafting these policies. As a result, Baylin had the discretion to not incorporate non-compliance with commercial agreements as a circumstance that would excuse a director that was not elected by the majority of shareholders from resigning. The court also emphasized that by expressly stipulating exceptional circumstances in their Policies, corporations like Baylin actually advanced the objectives of the TSX requirements by providing directors with a clearer picture of "where they stand in terms of compliance with the policy" should any issues arise.[4]

Oppression Remedy

Both the lower court and the Court of Appeal examined whether Baylin's Policy was oppressive to Gelerman under section 248 of the *Ontario Business Corporations Act*. Finding Gelerman held a reasonable expectation that he would be a director of Baylin for two years under the terms of the APA, the application judge found that the Policy was oppressive. For the application judge, not only did the Policy run contrary to the TSX requirements, but also appeared to be adopted to remove Gelerman as a director.

On appeal, the Court observed that reasonable expectations are to be viewed objectively in the context of the facts at hand.[5] The Court of Appeal stated that while Gelerman undoubtedly held a subjective view he would hold the position of director for two years, this view was not objectively reasonable. The APA did not stipulate he would be a director, only that Baylin would nominate him and make best efforts to assist him in his election. In fact, Baylin rejected Gelerman's request for a director position when negotiating the APA. Moreover, Gelerman was fully aware of 2385769's position on his election as director, but he ignored notices from Baylin and failed to take steps to ameliorate any issues. The Court of Appeal also noted that 2385789's position was reasonable and that the majority shareholder was, the circumstances, entitled to act in whatever manner it saw fit. Alongside the finding that Baylin's Policy was reasonable, the Court of Appeal dismissed Gelerman's claim that Baylin's conduct was oppressive.

Contractual Set-off

Relying on the indemnification terms of the APA, Baylin also sought to exercise its right to set-off against undelivered share certificates that its counsel held in trust as payment to Spacebridge for their consulting services. The lower court refused Baylin's set-off claim, holding that once it had delivered the share certificates to the trustee, Baylin no longer had any "amounts otherwise payable" to Spacebridge. As such, according to

the application judge, those certificates could not be subject to set-off.

However, the Court of Appeal found that even though Baylin delivered the certificates to its counsel at the outset of the Consulting Agreement, those amounts were not paid until they were released to Gelerman. As a result, any share certificates still held in trust remained "amounts otherwise payable" and could be subject to the set-off provision.

The Court of Appeal acknowledged that while Baylin could not advance its set-off claim under the doctrines of legal and equitable set-off because those concepts require mutual debts or are only available with respect to sums of money, contractual parties are free to override these principles in their contract. Under the ordinary meaning of the terms of the Consulting Agreement and the APA, the Baylin shares were included as part of the consideration exchanged between the parties and, therefore, were ordered to be withheld until Baylin's indemnity claims against Spacebridge were resolved.

Takeaways

Baylin gives rise to a number of considerations for all businesses, especially for those listed on the TSX. The decision confirms that withheld votes are to be included as votes against the election of a director. The Court of Appeal emphasized that security holders must be afforded meaningful ways to hold directors accountable in the event they are underperforming or unqualified and that majority voting policies are important mechanisms to ensure that principle is upheld.

While businesses listed on the TSX must abide by the requirements stipulated by the TSX, businesses are still afforded latitude when drafting these majority voting policies. *Baylin* suggests that businesses may be well-served in drafting these policies by outlining various exceptional circumstances that will be considered in the event that the resignation of one of its directors is tendered. While the application of these circumstances will vary from case-to-case, these policies still serve as useful tools for directors to understand where they may stand in the event they are subject to a vote. The narrower the "exceptional circumstances", the more say shareholders will have by minimizing the scenario in which a Board can override the majority of votes.

Finally, *Baylin* suggests that businesses are able to use well-crafted contractual set-off clauses to overcome basic legal and equitable set-off principles. Notably, contracts may be drafted to allow parties to mount a successful set-off claim for non-monetary property and in situations where no mutual debts exist.

[1][ps2id id='1' target='/] 2021 ONCA 45 [*Baylin*].
[2][ps2id id='2' target='/] Ontario Securities Commission, "TSX Notice of Approval" in *TSX Company Manual, Chapter 13: SROs, Marketplaces and Clearing Agencies*, (October 4, 2012), 35 OSCB 9151; see also: Ontario Securities Commission, "TSX Request for Comment, Amendments to Part IV of the TSX Company Manual" in

OSC Bulletin 34:36 (September 9, 2011), 34 OSCB 9500, p.9502.
[3][ps2id id='3' target='/] TSX Company Manual, Staff Notice 2017-0001, Staff Notice to Applicants, Listed Issuers, Securities Lawyers and Participating Organizations (9 March 2017).
[4][ps2id id='4' target='/] *Baylin* at para 43.
[5][ps2id id='5' target='/] *BCE Inc, Re*, 2008 SCC 69 at para 62.

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A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.