Canadian Coalition for
GOOD GOVERNANCE

THE VOICE OF THE SHAREHOLDER

BRIEF TO STANDING COMMITTEE ON INDUSTRY, SCIENCE AND TECHNOLOGY RE: FIVE YEAR REVIEW OF CBCA

Submitted February, 2010

This brief is provided to the Standing Committee on Industry, Science and Technology by the Canadian Coalition for Good Governance ("CCGG") in furtherance of the Committee's Five Year Review of the Canada Business Corporations Act ("CBCA"). This brief is further to the oral submissions made by CCGG at the hearing before the Committee on November 16, 2009.

The Committee should note that all of our recommended amendments to the CBCA should only apply to CBCA public companies, not CBCA private companies.

I. INTRODUCTION

A. The Canadian Coalition for Good Governance

CCGG is a coalition of approximately 45 of Canada's leading institutional investors (such as pension plans, investment managers and mutual fund managers) managing retirement assets of over $1.2 trillion, representing more than half of the retirement savings of all Canadians. Attached as Appendix "A" is a list of CCGG's members.

CCGG promotes good governance practices in Canadian public companies and the improvement of the regulatory environment to:

- Align the interests of boards and management with those of their shareholders
- Promote the efficiency and effectiveness of the Canadian capital markets

Canadian corporate law requirements for public companies in the area of governance have not kept pace with domestic or international best practices. Over time, CCGG has issued best practices guidelines and urged companies to adopt them in advance of legislative change. Many companies have adopted these best practices with no disruption to their business. Some companies have not, however, and have indicated to us that they have no intention of doing so.

It is time to update the CBCA to reflect best corporate governance practices so that all CBCA public companies are required to implement them. Doing so will propel Canada forward as a governance leader at a time when countries around the world are increasingly recognizing the importance of good governance practices.

B. Why good governance matters

It is important for the Committee to understand why good governance is so important for Canadian companies and the Canadian capital markets. First and foremost, there is mounting evidence that good governance leads to the more efficient use of capital and better investment returns. The CBCA should enshrine governance norms that will improve the performance of Canadian public companies and attract capital to them from Canada and internationally.

As the providers of capital and ultimate owners of a company, shareholders delegate certain powers to boards of directors, including the powers over:

- Corporate strategy;
- Hiring CEOs (and often other senior executives) to design and execute strategy, monitoring their performance and establishing appropriate compensation plans;
- Core corporate functions, including oversight of audit, finance and human resources;
- Risk management; and
- Crisis management

As the overseers of senior executives and long-term corporate strategy, directors are the cornerstone of good governance. In order for them to fulfill that role, however, they must be accountable to shareholders and largely independent of management. Without accountability, there is a risk that directors' interests will become more aligned with those of management, rather than those of the shareholders.

In order to facilitate director's accountability to shareholders, the CBCA should be amended to enshrine basic democratic and governance norms for public companies, including:

- a fair process to elect directors;
- the ability of shareholders to nominate and remove directors;
- a voting system that accurately reflects votes cast and reports voting results;
- the ability of shareholders to approve significantly dilutive transactions; and
- the separation of the CEO and Chair of the board

II. SUMMARY OF RECOMMENDATIONS

We recommend the following amendments to the CBCA, each of which is discussed in detail below.

Recommendation #1	**The Committee should broaden its consultations**
Recommendation #2	**The CBCA should prohibit slate voting and require a director by director vote**
Recommendation #3	**The CBCA should require a majority voting standard for director elections**
Recommendation #4	**The CBCA should require annual director elections for all CBCA public companies**
Recommendation #5	**The CBCA should require public companies to disclose the detailed results of shareholder votes for matters on the ballot**
Recommendation #6	**The CBCA should be amended to give significant shareholders access to the proxy circular**
Recommendation #7	**The CBCA should require all shareholders to be treated equally in the proxy process, irrespective of whether they want to protect the privacy of their information**
Recommendation #8	**The CBCA should facilitate "notice and access"**
Recommendation #9	**The CBCA should generally require the separation of the roles of chief executive officer and chair of the board**
Recommendation #10	**The CBCA should require shareholder approval for significantly dilutive acquisitions**
Recommendation #11	**The Committee should devise ways to give shareholders more meaningful ways to resolve claims under the oppression remedy**

III. THE CBCA FIVE YEAR REVIEW PROCESS

Recommendation #1 – The Committee should broaden its consultations

CCGG urges the Committee to broaden its consultation process as part of this Five Year Review. The CBCA is a critically important piece of legislation that establishes key governance and other requirements for companies that carry on business throughout the country, and is seen as a model for its various provincial counterparts. Numerous other groups would provide the Committee with important insights and perspectives, including academics, regulators, issuers, and issuers' counsel. It is particularly important for the Committee to consult with members of the Canadian Securities Administrators (the "CSA") as there are important proposed securities law reforms that may require changes to the CBCA and/or its regulations in order to be effective.

IV. BASIC DEMOCRATIC NORMS FOR VOTING BY INVESTORS

Because shareholders delegate their authority to the directors, shareholders are only empowered to vote on a small number of matters that are critical to the ongoing functioning of the company, such as the election of directors and the appointment of the auditor. It is essential that the voting process be democratic, fair and transparent. The following amendments are required in order for the CBCA to reflect these values.

Recommendation #2 – The CBCA should prohibit slate voting and require a director by director vote.

Currently, it is common practice for companies to propose a slate of directors and require shareholders to vote for all or none of them, commonly referred to as "slate voting". Although CCGG has urged companies to abandon this practice, approximately 25% of the largest Canadian companies (companies in the TSX/S&P Composite Index) still have slate voting. Slate voting is even more common in smaller companies. The CBCA should be amended to prohibit slate voting.

Recommendation #3 – The CBCA should require a majority voting standard for director elections

The lack of accountability caused by slate voting is compounded by the fact that directors can be elected without receiving a majority of votes in their favour. Currently, under the CBCA and provincial securities legislation, shareholders of public companies do not have the power to vote by proxy "for" or "against" directors. Their only right is to vote "for" them, or "withhold" their vote. A "withhold" vote has no practical effect. As a result, directors in a public company can be elected if they receive only one vote – and if they are a shareholder (which they often are), that vote can be their own!

Directors cannot be truly accountable to shareholders if shareholders have no meaningful way to remove them from the board.   Under the current system, a director can lose an election by any normal measure – receiving less than 50% of the votes or even receiving just one vote – and not have to vacate their seat on the board. Recent statistics from the United States reveal why majority voting is so important. Risk Metrics reports that as of September 23, 2009, 91 directors at 49 different companies failed to receive majority support (three times as many as in all of 2008), yet not one of those directors resigned from their board.

Previously, s. 54 of the CBCA Regulations required that votes for directors had to be in the form of either "for" or "withhold". However, that regulation was recently amended to provide that the form of proxy must be as required by s. 9.4 of NI 51-102, an instrument of the CSA. Section 9.4 simply replicates the previous CBCA requirement that votes for directors must be in the form of either "for" or "withhold".

As a result of that amendment, the form of voting for director elections has effectively been delegated to the CSA. We understand, however, that the CSA is reluctant to establish rules in this area since the structure of director elections has historically been a matter of corporate law. An amendment to the CBCA requiring a majority voting standard for director elections would provide important clarification in that regard.

The for/withhold structure for director elections now found in s. 9.4 of NI 51-102 also appears to conflict with s. 106(3) of the CBCA which provides that shareholders can elect directors by "ordinary resolution". That wording implies that shareholders can vote for or against directors, which s. 9.4 states they cannot, at least in respect of voting by proxy. It is inconsistent to allow registered shareholders who attend a meeting to vote against directors and not to allow shareholders who vote by proxy to do the same. Section 106(3) of the CBCA should be amended to clearly state that directors must be elected by majority vote, notwithstanding any provisions to the contrary in any other Act or regulations.

Until all applicable corporate laws are changed, CCGG has developed a "majority voting" board policy which provides a framework to allow companies to establish majority voting. In general, the policy provides that a director who fails to win a majority of votes in their favour must resign their seat on the board. Our policy has already been substantially adopted by 98 of Canada's largest companies which demonstrates that majority voting can be implemented without business interruption.

Opponents of majority voting often argue that requiring directors to obtain majority support before they are elected could lead to "failed elections", i.e. elections where an insufficient number of directors are elected to achieve the required quorum for the board. This is a very unlikely scenario for two reasons. First, shareholders are very reluctant to block the election of a director absent a compelling reason to do so. Second, if a shareholder intends to block the election of more than one director, that shareholder would most likely be proposing his/her own directors for election at the same meeting.

Even without majority voting, all CBCA public companies already operate with the risk that they will lose directors to the point where they no longer have quorum or have any directors at all (such as through a resignation en masse).

In any event, existing sections of the CBCA establish a process to follow if one or more directors are not re-elected at an annual meeting. Under s. 111 of the CBCA, if a director is not re-elected, the remaining directors (as long as they constitute a quorum) can appoint a director to fill that vacancy for the remainder of the term of the original director. If an election results in less than a quorum of directors elected or if there has been a failure to elect the number of directors required by a company's articles, then the directors are required to call a special meeting of the shareholders without delay in order to fill the vacancy. In the very unlikely event that an election results in no directors being elected, the special meeting can be called by any shareholder.

Similarly, if a director is removed from office at a special meeting called for the purpose of removing directors, s. 109 of the CBCA allows that vacancy to be filled by a resolution of the shareholders at that meeting. Alternatively, a new director may be appointed by the remaining directors according to the process established under s. 111, as set out above.

The Committee should ensure that any provisions added to the CBCA to establish majority voting address how a majority will be achieved when multiple nominees are put forward for a smaller number of vacancies.

The Committee should note that to the best of our knowledge, Canada and the United States are the only jurisdictions that do not use a majority voting system for director elections.

Recommendation #4 – The CBCA should require annual director elections for all CBCA public companies

Currently, under s. 106(3) of the CBCA, directors can be elected for up to three years and can be elected for terms of different lengths. Boards that allow directors to be elected for different terms are referred to as "staggered boards". Staggered boards can impede the ability of shareholders to make needed changes to the board, as not all directors come up for re-election each year. For example, if an issue regarding compensation arises and there are three members of a compensation committee, each of whom has a different three year term, it can take up to four years to replace the entire committee (unless a special meeting is requisitioned).

However, the Committee should note that all large Canadian companies have already moved to annual director elections which have not caused any disruptions to boards or their ability to engage in long-term planning. In fact, directors at the 127 companies in the S&P/TSX Composite that report the results of annual director elections received an average of 96.8% votes in their favour. Interestingly, the directors at the 78 companies in that index with a majority voting policy that report the result of annual director elections received even greater support, with an average of 97.9% of votes in their favour.

This should address the concerns raised by several committee members at the hearing on November 16, 2009 who questioned whether annual director elections would be disruptive to boards. The CBCA should be amended to require annual director elections for all CBCA public companies.

Recommendation #5 – The CBCA should require public companies to disclose the detailed results of shareholder votes for matters on the ballot

Section 141 of the CBCA currently provides that voting at a meeting of shareholders may take place by show of hands, unless a shareholder or proxy holder entitled to vote at the meeting demands a ballot.

If a matter is passed by way of a show of hands, under s. 142(3) of the CBCA and applicable securities laws the company is only required to record and disclose the fact that a resolution was carried or defeated, without disclosing the number of votes cast for or against the resolution. In contrast, if a vote is conducted by ballot a company must provide much more detailed information including the votes cast in person and by proxy and the number or percentage of votes cast for, against or withheld from the vote.

Several problems result from the lack of transparency of this process. A report that only states whether a matter was passed or defeated does not give shareholders any information through which they can assess the level of shareholder support for matters on the ballot (such as director elections), nor can they ascertain any trends in changing levels of support.

In addition, companies are not under any obligation to confirm to shareholders who submit their votes by proxy that their votes have been received and tabulated. This lack of confirmation, when coupled with the fact that the vote results are not reported, makes it virtually impossible for shareholders to independently confirm that their votes have been counted.

CCGG does not take issue with show of hands voting and summary reporting of whether the matter was carried or defeated for routine procedural matters related to the conduct of the meeting. However companies should be required to report detailed and accurate voting results for all matters listed on the proxy, including director elections. CCGG has been urging companies to provide detailed voting results as a matter of best practice. Many of Canada's largest companies voluntarily report their voting results for director elections, but 38% of companies in the TSX/S&P Composite still do not. (That number would likely be much higher if smaller companies were considered.) All CBCA public companies should be required to disclose the detailed results of shareholder votes for all substantive matters listed on the proxy.

The Committee should note that companies already have all of the detailed results of any vote (other than a show of hands vote) in a report that is prepared by a scrutineer who attends the meeting and tabulates the vote. Requiring companies to disclose that information would not impose any additional administrative burden.

Recommendation #6 – The CBCA should be amended to give significant shareholders access to the management proxy circular

Under the CBCA and applicable securities laws, it is difficult and expensive for a shareholder to propose alternate directors for election and to actively solicit other shareholders to vote for their nominees. Currently, shareholders who wish to do so have the following four options:

1) A shareholder could prepare and mail its own dissident proxy circular in advance of the annual meeting. The dissident circular would include the names and backgrounds of the directors proposed for election and a statement as to why they should be elected. The estimated cost of doing so is a minimum of $500,000 (including legal fees, printing and mailing costs) and would be considerably more for a large company or if a proxy solicitation service is used. These costs are prohibitive for most shareholders. While a successful shareholder can seek reimbursement of its expenses, there is no guarantee that the company will reimburse it.

   Any shareholder that does incur the expense of preparing a dissident circular is also at a considerable economic disadvantage vis-à-vis management and an incumbent board which are able to use the company's resources to prepare the management information circular urging the election of their preferred directors.

2) If a shareholder holds 5% or more of the shares (which is rarely the case for an individual or institutional investor) the shareholder can:
   a. Request that the management circular include a shareholder "proposal" calling for the election of different directors. A shareholder is limited to a 500 word statement in support of its directors, whereas management can

issue a responding statement of unlimited length. A shareholder can issue a general public statement explaining its position, but can only directly solicit up to 15 other shareholders unless it prepares a dissident proxy circular at the prohibitive expense noted above, or

b. Requisition a special meeting to elect new directors and issue a proxy circular at its own expense. A shareholder is entitled to be reimbursed for its reasonable expenses unless the shareholders at the special meeting resolve otherwise.

Although the CBCA permits several shareholders to aggregate their holdings to reach the 5% threshold, those shareholders may then be considered to be "acting in concert" which may have ramifications under provincial securities law and may require those shareholders to make onerous filings in the U.S. In most public companies, this option is of little use and would still not permit the broad solicitation of other shareholders without the preparation of a dissident proxy circular.

3) A shareholder can ask the company to agree to include the shareholder's alternative director nominees in the management proxy circular, but it is highly unlikely that such consent would ever be given.

4) Subject to a company's specific by-laws, a shareholder could attend the annual meeting and propose alternative directors. However, most shareholders vote their shares in advance of the annual meeting by proxy so this strategy would rarely be successful. Moreover, many shareholders grant discretionary authority to management in their proxies who would inevitably vote in favour of management's director nominees.

The CBCA should be amended to make it easier for significant shareholders to nominate alternative directors, if they deem it necessary to do so. The CBCA should provide that a significant shareholder (holding 5% of shares alone or with others) can require a company to include in its management proxy circular a shareholder's alternative nominees for directors, together with a description of their backgrounds and a statement from the shareholder as to why they should be elected. That shareholder should be able to freely solicit the support of other shareholders without the need to file a dissident proxy circular.

The inclusion of a shareholder's nominees in the management proxy circular should be at no cost to the shareholder and the shareholder should be reimbursed by the company for its reasonable solicitation costs, unless the shareholders resolve otherwise.

The Committee may want to consider whether it would be appropriate to require significant shareholders to hold their shares for a minimum period of time before they are allowed to propose their own directors in the management proxy circular, as is currently being debated in the United States.

Recommendation #7 – The CBCA should contain a positive obligation on corporations to send proxy related material to all of their shareholders, irrespective of whether they choose to protect the privacy of their information

Most shareholders hold their securities through an intermediary, such as a brokerage firm or custodian. In those circumstances, the registered holder of the security is the brokerage firm or custodian, but the beneficial owner is the shareholder.

Provincial securities laws allow beneficial owners to protect their "ownership information" from being disclosed to a company in which they own shares. "Ownership information" includes the name and address of shareholders and information about the securities held in their account. If a beneficial owner does not want this information disclosed they are referred to as "objecting beneficial owners" or "OBOs". Beneficial owners who do not object to the disclosure of their ownership information are referred to as "non-objecting beneficial owners" or "NOBOs". Investors are increasingly choosing to protect their personal information. According to Broadridge, the market leader in investor communications services, approximately 50% of shareholders are currently OBOs, which has risen from 38% in 2005.

Provincial securities laws currently provide that when a company sends out proxy related materials to shareholders to enable them to vote at a meeting, they are required to pay for the distribution of those materials, unless the shareholder in question is an OBO, in which case they have no such obligation. Unless the intermediary or the shareholders themselves pay to receive proxy related material, OBOs will not receive the information necessary for them to exercise their voting rights. According to Broadridge, in 2009, 1390 issuers or 36% refused to pay for proxy material to be sent to OBOs, up from 345 issuers in 2008. As a result, approximately 148,000 OBOs, representing approximately 4.2 billion shares, received no proxy materials and were prevented from voting their shares.

Issuers should be required to send proxy materials to OBOs at the issuer's expense. There is no principled reason to treat OBOs differently than NOBOs. The CBCA should include a provision requiring all shareholders to be treated equally in the proxy process, irrespective of whether they want to protect the privacy of their personal information.

Recommendation #8 – The CBCA should facilitate "notice and access"

The CSA has been developing a "notice and access" proposal, whereby shareholders will be able to access and download documents from companies' websites to facilitate proxy voting. A 'notice and access' system has been developed in the U.S. and is generally seen to encourage proxy voting, lower costs and make the proxy system more efficient. However, since various provisions of the CBCA impose obligations on intermediaries to forward documents to shareholders in writing, the CSA is concerned that its proposals may interfere with CBCA requirements. It is important for the Committee to consult with the CSA on this issue (and generally, as set out in Recommendation #1) to ensure that provisions of the CBCA are not an obstacle to the CSA's ability to proceed with these important reforms to the proxy voting system.

V. BASIC GOVERNANCE NORMS

There are numerous governance norms that have become internationally accepted best practices, and voluntarily adopted by a large number of Canadian companies, but are not yet required by the CBCA. The following amendments to the CBCA are required to reflect these best practices.

Recommendation #9 – The CBCA should generally require the separation of the roles of chief executive officer and chair of the board

One of the key roles of the board of a public company is to oversee management, particularly the CEO. If the chair of the board is also the CEO, the board may have difficulties carrying out its supervisory function. The chair of the board sets the agenda for board meetings and ensures that directors have the necessary information. The chair is also responsible for conducting board meetings in a way that fosters constructive debate and appropriate challenges to management. Good governance generally requires the chair of the board to be someone other than the CEO and to be independent of management.

On a transitional basis, a board could consider appointing a lead director independent of management to carry out the functions of the chair of the board as the board moves towards fully separating the roles of CEO and chair of the board.

If there is a controlling shareholder of the company, the chair of the board should be independent of that shareholder or a lead director independent of the controlling shareholder should be appointed.

CCGG has been urging companies to voluntarily separate the role of the CEO and the chair of the board. Of the 157 largest corporate issuers in Canada, only 72 have a chair of the board that is independent of management.

Recommendation #10 – The CBCA should require shareholder approval for significantly dilutive acquisitions

Under the CBCA, shareholders have the right to approve certain fundamental changes to the corporation including the sale, lease or exchange of substantially all of the assets of the corporation, the issuance of a new class of shares, changes to the rights associated with certain shares, an amalgamation with another corporation and a going private transaction.

Shareholders should similarly have the right to approve a significant corporate acquisition that is paid for in shares if it will dilute the value of the shares held by existing shareholders by more than 25%. The TSX recently changed its listing requirements to require all TSX listed companies to obtain shareholder approval in those circumstances. A similar requirement is found in the listing standards of most major exchanges and/or in the corporate law of the jurisdictions in which the exchanges operate. The CBCA should similarly require shareholder approval for dilutive acquisitions.

VI. REMEDIES FOR INVESTORS

Recommendation #11 – The Committee should devise ways to give shareholders more meaningful ways to resolve claims under the oppression remedy

The oppression remedy under s. 241 of the CBCA is a critically important remedy for shareholders and others (referred to in the CBCA as "complainants") who seek redress for corporate actions that result in their interests being prejudiced or unfairly disregarded. However, the section as it currently stands does not provide shareholders with meaningful access to a remedy.

First, the cost of bringing an application in court for relief under s. 241 can be prohibitively expensive, even for large institutional shareholders. In contrast, the company and its directors and officers may use corporate assets to fund their defence to claims for relief under s. 241.

Perhaps more significantly, the court process through which remedies can be obtained under s. 241 typically involves lengthy delays. Those delays, together with the delay caused by multiple levels of appeal, can result in complainants not obtaining relief for many years.

Laudably, the CBCA attempts to ameliorate the cost burden on a complainant by allowing a court to order a company to pay interim costs to that complainant. However, even if a complainant is successful in obtaining such an order, it would still have to invest considerable resources to pursue its action. Interim cost orders also do not address the problem of delay.

The Committee should devise ways to reduce the costs and delays involved in resolving claims under the oppression remedy in order to make it a meaningful remedy for shareholders, perhaps by establishing a process whereby those claims could be arbitrated.

VII. CONCLUSION

The statutory review of the CBCA provides a unique opportunity for Canada. The financial crisis has brought a new focus on governance and the critical role it plays in ensuring the long-term profitability of companies. Internationally, there is an emerging consensus that governance reforms are necessary to ensure that companies are well-run and accountable to their shareholders. For example, of the three major pieces of governance-related legislation that have been introduced in the U.S. since the financial crisis, two will abolish staggered boards and all three will require majority voting for director elections and the separation of the CEO and chair of the board. The SEC has developed a proposal to give shareholders access to the proxy. Proposed legislation in the U.S. will even require a shareholder advisory vote on compensation for all U.S. public companies.

Enshrining our recommended governance reforms in the CBCA will give Canada an opportunity to become a governance leader, thus encouraging the flow of capital to Canadian public companies and the more efficient use of that capital once invested.

Appendix “A” - CCGG MEMBERS

Acuity Investment Management Inc.
Alberta Investment Management Corporation (AIMCo)
Alberta Teachers' Retirement Fund Board
Aurion Capital Management Inc.
BlackRock Asset Management Canada Limited
BMO Harris Investment Management Inc.
British Columbia Investment Management Corporation (bcIMC)
Burgundy Asset Management Ltd.
Canada Post Corporation Registered Pension Plan
CIBC Global Asset Management
Colleges of Applied Arts and Technology Pension Plan (CAAT)
Connor, Clark & Lunn Investment Management
CPP Investment Board
Franklin Templeton Investments Corp.
Genus Capital Management
Greystone Managed Investments Inc.
Hospitals of Ontario Pension Plan (HOOPP)
Jarislowsky Fraser Limited
Leith Wheeler Investment Counsel Ltd.
Lincluden Investment Management
Mackenzie Financial Corporation
McLean Budden Limited
MFC Global Investment Management
New Brunswick Investment Management Corporation (NBIMC)
Northwest & Ethical Investments L.P.
Ontario Municipal Employees Retirement Board (OMERS)
Ontario Pension Board
Ontario Teachers' Pension Plan (Teachers')
OPSEU Pension Trust
Public Sector Pension Investment Board (PSP Investments)
RBC Asset Management Inc.
Régimes de retraite de la Société de transport de Montréal
Scotia Asset Management L.P.
SEAMARK Asset Management Ltd.
Sionna Investment Managers Inc.
Standard Life Investments Inc.
TD Asset Management Inc.
UBS Global Asset Management (Canada) Co.
University of Toronto Asset Management Corporation (UTAM)
Workers' Compensation Board - Alberta
York University Pension Fund