Majority Voting

Getting it Right

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April 11, 2017

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Executive Summary

We are at an important inflexion point in the evolution of shareholder voting in Canada. The federal government is proposing to change the way in which directors of public companies governed by the CBCA are elected. The proposed changes respond to shareholder demands for "majority voting" (the requirement that directors be elected by a majority of votes cast). However, they create a regime that is very different from the current majority voting regime in place for TSX listed companies.

If the proposed amendments come into force, directors of public companies governed by the CBCA will face "sudden death elections" as early as the 2018 proxy season. The board will have no discretion to keep a director on the board who has been voted down by shareholders, even for a transition period while the board tries to replace the skills and experience it has lost (subject to two exceptions). Succession plans will need to be rethought to deal with gaps in the board's skill set and experience on an expedited basis. Companies will need to prepare to deal with change in control provisions in employment contracts and loan agreements that could be triggered, and the potential for both new activist tactics and increased proxy solicitation costs. These changes in director voting will affect over 40% of the corporations listed on the S&P/TSX Composite Index. They merit thoughtful discussion before they are implemented.

Time is short. As we release this Discussion Paper, the amendments are awaiting third reading in the House of Commons. Once they pass third reading, they will go to the Senate. There has been too little discussion about the implications of the proposed amendments for companies governed by the CBCA and for the capital markets more generally.

We hope our Discussion Paper will inform and encourage discussion on this important topic. We welcome comments. Please contact any member of our firms or email us at majorityvoting@hanselladvisory.com.

Overview of Issues

We have discussed the complicated topic of majority voting in detail in our Discussion Paper. The following facts stand out for us as being particularly important in determining the path forward for majority voting in Canada.[1]

- **Shareholders overwhelmingly support candidates for election** – In the vast majority of uncontested elections, directors receive the support of over 94% of shareholders who vote.

- **Directors who have been voted down by shareholders routinely step off the board** – There have been very few directors who have remained on the board contrary to the majority views of shareholders) in Canada since the TSX introduced mandatory majority voting for its listed issuers in 2014.

- **Broad support for majority voting** – There is broad support for majority voting as the appropriate standard for TSX listed companies.

- **Stakeholders disagree fundamentally about how to implement majority voting** – There is clear division among stakeholders about how to implement majority voting.

    - Institutional investors represented by the Canadian Coalition for Good Governance (CCGG) believe that majority voting should be enshrined in corporate law, eliminating the ability of the board to override the majority view of shareholders.

    - Organizations representing issuers and directors believe that majority voting is best handled by the TSX (or by securities regulators), allowing listed companies to address extraordinary circumstances that may be unnecessarily disruptive to the company's business.

- **Sudden death elections proposed by the federal government have significant disruptive potential** – The sudden death elections proposed by the federal government for CBCA companies have the potential to distract and even paralyze public companies.

    - The view that there are many board ready Canadians who could step in on short notice to fill out the board's skill set makes light of the priority that boards and shareholders alike have assigned to skills-based boards and succession planning.

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[1] The analysis underlying the issues we raise is based on public companies on the S&P/TSX Composite Index. These companies represent 95% of the market capitalization of all Canadian companies.

- While many boards have evergreen lists of potential board candidates, these candidates are often not available on short notice to step in when an incumbent director has been voted down by shareholders.

- CBCA public companies may be thrown offside regulatory requirements.

- Change-in-control provisions in key contracts may be triggered immediately.

- Activists may take advantage of the changes in director elections to take control of a board without a proxy contest.

❖ **Viable, less disruptive alternatives to implement majority voting are available** – If the policy decision of government is that majority voting should be codified in corporate law, that result can be achieved in far less disruptive ways. We outline a number of alternatives in our Discussion Paper. They include, for example, a 90-120 day hold period to eliminate the risk of immediate breach of statutory and regulatory requirements and to allow the board to identify and recruit appropriate replacements for the directors who have been voted off the board.

❖ **Changes to director elections for CBCA companies alone will cause confusion** – Investors in Canadian companies (both domestic and international) will be required to deal with a fragmented director election regime in Canada. This has the potential to diminish the view that international investors in particular have of Canadian governance and to compromise our competitiveness for international capital.

Conclusions and Recommendations

The amendments to the CBCA currently being proposed with respect to majority voting would be unnecessarily disruptive to the business of public companies governed by the CBCA. If the federal government proceeds with those amendments, they should be revised to minimize that disruption. Our Discussion Paper sets out a number of ways this could be accomplished.

However, we suggest that the federal government reconsider whether any change to the CBCA to provide for majority voting is required (immediately, or at all). Companies representing 98.53% of the quoted market value of the Canadian capital markets are already subject to the majority voting requirements of the TSX. It is early days, but these requirements appear to be meeting the policy objectives underlying majority voting. When it comes to public companies listed on the TSXV, considerable thought needs to be given to the dynamics of that marketplace and to the size and resources of the issuers. With the TSXV itself being opposed to the introduction of majority voting for its listed companies and no shareholder groups with specific focus on TSXV companies advocating in favour of majority voting, it is difficult to see why the federal government should impose this change in director elections on these companies.

Changes in the way in which directors are elected under the CBCA will have immediate and meaningful consequences for a large percentage of public companies in Canada. In the absence of any existing governance crisis, it is more important that any amendments be implemented thoughtfully than that they be implemented quickly. The consultation process that led to the amendments being proposed to the CBCA was not extensive or transparent enough to give stakeholders an opportunity to comment. The views of certain key stakeholders who did provide input (including representatives of issuers and of corporate directors) seem to have carried little weight. We recommend that a broader consultation process be held to consider how majority voting should best be handled in the Canadian marketplace. As part of that consultation process, the federal government should discuss with stakeholders whether public company governance issues such as majority voting should be addressed in corporate law or through securities regulation.

We have made a number of more specific recommendations throughout this Discussion Paper. We hope that some of them will form the basis of an approach to majority voting in Canada that meets the needs of a wider range of stakeholders.

About the Discussion Paper

Our Discussion Paper is available here. It is the result of four months of research, analysis and consultation by members of the Hansell McLaughlin Advisory Group. Our team consists of lawyers (through Hansell LLP), government relations and communications specialists (through Hansell Mclaughlin Advisory Inc.) and governance experts in both firms.

We have not been retained or compensated by any person in connection with this work. We offer it as a contribution to informed discussion and debate on a topic that is important to the Canadian capital markets.

Finally, we extend sincere thanks to the members of the capital markets community who assisted us with this paper.

Data used to inform this report have been provided by the Clarkson Centre for Business Ethics and Board Effectiveness at the Rotman School of Management, University of Toronto.

Additional data has been provided by Hansell McLaughlin Advisory.

Majority Voting – Getting It Right

Director elections in public companies[2] are similar in many ways to political elections. The shareholder (or voter) can vote in favour of a candidate, but there is no opportunity to vote against a candidate. The rub in the director election process is that, because the nominations are typically controlled by the incumbent board and elections are almost always uncontested, public company shareholders must accept the candidates put forward, whether they support them or not. The difference in the political world is that elections are almost always contested – voters may not like any of the candidates put forward, but they do typically have a choice. It is true that shareholders can nominate their own candidates or call a special meeting to remove directors whom they find unacceptable, but there are costs (financial and otherwise) associated with these extraordinary actions that make them largely impractical.

Shareholder demands for majority voting (the requirement that directors be elected by a majority of votes cast) have been mounting for more than a decade. Simply put, many institutional investors do not think that a person should sit as a director without the majority support of shareholders (through the support of a majority of votes cast with respect to his or her election). The challenge has been in how to achieve the desired outcome. Director elections are grounded in corporate law, which is amended infrequently. To achieve more immediate results, Canadian shareholders successfully pushed public companies to voluntarily adopt majority voting for uncontested elections. By 2012, almost two-thirds of companies listed on the S&P/TSX Composite Index had done so. The TSX then introduced a comply or explain approach to majority voting, and the number of TSX companies that had adopted majority voting rose to 88%.

In order to capture the balance of TSX listed companies and establish a consistent approach to majority voting, the TSX changed its listing requirements in 2014 to require companies listed on that exchange (subject to certain exceptions) to adopt majority voting for uncontested director elections. While there were a handful of situations in the 2015 proxy season in which TSX listed issuers kept on their board, directors who had been voted down by shareholders, there were no such situations in 2016. As we progress through the 2017 season, the TSX is monitoring the director elections of its listed companies for compliance with the policy objectives of the TSX majority voting listing requirements.

Just as the TSX majority voting regime is taking hold, the federal government is proposing to take public companies governed by the *Canada Business Corporations Act* (CBCA) in a different direction. It proposes to amend the director election process to provide that a director candidate will not be elected without the support of a majority of shareholders who

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[2] The term "company" in this paper has the same meaning as in the TSX Company Manual (ie. the meaning ascribed to "company" in the *Securities Act* (Ontario) and also includes a trust, partnership or other form of business organization).

cast their votes. This will eliminate, for CBCA public companies, the ability of the board to consider whether there are "exceptional circumstances" that warrant keeping a director who has been voted down on the board for a period of time. There is significant opposition from public companies and their representatives to the approach taken by the federal government to implement majority voting. Other jurisdictions will be called upon to decide how they should approach majority voting. Ideally, discussion among capital markets participants will produce a better solution for CBCA companies than is currently proposed. Beyond that, the discussion should continue in order to inform the deliberations in other jurisdictions.

In this Discussion Paper, we discuss the importance of majority voting. We also examine the proposed CBCA amendments closely, describing challenges they will create for companies and suggesting some alternatives for consideration. We are confident that a solution can be developed that is consistent with shareholder democracy and that allows the board to respect and action decisions made by the shareholders without unnecessary disruption to the business.

The amendments being proposed to the CBCA and its regulations are set out in Schedules A and B to this paper. In Schedule C, we describe the history of majority voting in Canada. We have the results of other aspects of our research in other schedules to this Discussion Paper in the hopes that this research will facilitate informed discussion about majority voting.

Part I – The Majority Voting Debate

The purpose of majority voting is to enhance accountability of directors to the shareholders who elect them. This part of the Discussion Paper explains why the current election regime fails to provide that accountability and how the federal government is proposing to address this gap through changes to the director election process in corporate law.

1. Annual meetings and the accountability of directors to shareholders

1.1 The right of shareholders to elect directors

Shareholders elect directors at the annual meeting each year. Since the 19th century, courts and legislators have protected this right, guarding against the incumbent board stepping in front of shareholders and appointing directors themselves. The proxy voting system was introduced to ensure that shareholders are able to exercise their voting rights, even if they are unable to attend the annual meeting. The form of proxy used by shareholders to provide their voting instructions is prescribed by law to protect against the incumbent board sending to shareholders a form of proxy that could lend itself to manipulation or undue influence.

Notwithstanding the authority of shareholders to elect directors, in most cases they have surprising little influence over who serves on the boards in which they invest. Elections are typically uncontested. The incumbent board is responsible for nominating candidates for election and shareholders have no ability to vote against any candidate proposed by the board. Each of these features of the director election process is discussed below.

1.2 How directors are nominated

In widely held public companies, it is generally impractical for shareholders to identify candidates for election at annual meetings. They look to the directors to consider the appropriate composition for the board, to recruit suitable candidates and to engage in a thoughtful board succession planning process.

The nomination process led by independent directors has been an important feature of modern corporate governance for more than 25 years. Previously, the chief executive officer played a dominant (if not exclusive) role in selecting directors, a practice that left directors beholden to the CEO they were tasked to oversee. The nomination process has developed well beyond ensuring simply that the board is independent from management. The independent nominating committee assesses the skills required at the board level in order to oversee management, and recruits new candidates for election based on skills required that are not represented on the board. The nominating committee also deals with succession planning, often maintaining evergreen lists of potential candidates with appropriate skills and experience to fill vacancies. As part of its succession planning, the nominating committee will

also consider whether the skills and expertise of the board align with the needs of the company as it executes on its strategic plan. Finally, the nominating committee considers how a potential director candidate would contribute to a board dynamic that provides effective, constructive oversight of management.

Of course, shareholders may nominate candidates for election themselves. The gating issue is often the cost involved in doing so, a cost that is typically born by the shareholder who puts the nomination forward. In some cases, a shareholder may persuade a board to recommend one or more of its nominees. In Canada (unlike the United States) shareholders also have "proxy access", meaning the right to have director nominees of their choosing included in the company's proxy circular and on the proxy (subject to certain restrictions). However, without investing the necessary resources to convince other shareholders to support their candidates, shareholders who use the proxy access tool may find it challenging to have their nominees elected.

Shareholders may also put alternative candidates forward on a separate proxy accompanied by a separate proxy circular or nominate candidates from the floor. There are a host of proxy solicitation rules, advance notice hurdles and other requirements and restrictions that make proxy contests expensive and time consuming.

1.3 The proxy does not permit shareholders to vote against a director candidate

As noted above, the proxy that shareholders use to provide their voting instructions does not allow shareholders to vote against a candidate for election. The shareholder may mark the "for" box or the "withhold" box. The "withhold" box has no effect on the outcome of the election. Accordingly, all of the candidates listed on the proxy will be elected if the election is uncontested (provided at least one person votes in favour of each candidate).

A more detailed explanation of the "withhold" vote is set out in Section 4.4.2 of this Discussion Paper.

1.4 Appointment of directors between annual meetings

Between annual meetings directors are not elected by shareholders, but rather are appointed by the board. This authority, while necessary in order to prevent governance issues from impeding the company's business, does little to promote a sense of accountability of directors to shareholders.

The board may appoint a new director to fill a vacancy between annual meetings. In order not to handicap the board when an incumbent director dies or resigns, the statutes allow the board to fill vacancies between annual meetings without consulting shareholders (provided there is a quorum of directors in office).

The corporate statutes also give the board some limited ability to expand the board (if the articles so provide) and select additional directors between annual meetings without consulting shareholders. This gives the board the flexibility to respond to changing circumstances. This authority will be incorporated into the CBCA if the proposed amendments to the CBCA proceed, eliminating the need for shareholders to agree to this authority through the articles.

1.5 Majority voting as a means to achieve accountability

1.5.1 Demand by shareholders for majority voting

In response to the lack of accountability created by the existing director election process, shareholders began demanding a change in that process in the form of majority voting.

1.5.2 Majority voting vs binding majority voting

Majority voting in Canada today (as prescribed by the TSX for its listed issuers) is described in detail in Section 2 below. Among other things, a board may override the majority vote of shareholders in "exceptional circumstances".

In contrast, "binding majority voting" means that a candidate who does not receive a majority of "for" votes in an uncontested election will not be elected in the first place. There is no role for the board in determining whether a candidate who has been voted down by shareholders may serve on the board. The consequences of the shareholder vote are immediate. Binding majority voting is sometimes referred to as "true majority voting".

2. Majority voting requirements for TSX listed companies

2.1 Directors elected annually by majority vote

Public companies listed on the TSX are subject to the majority voting requirements of that exchange. Each director must be elected individually for a one-year term and by a majority (50% + 1) of the votes cast "for" with respect to his or her election at an uncontested meeting.

2.2 Board may override the majority vote in exceptional circumstance

In addition, companies listed on the TSX must adopt a policy[3] that provides that a director who does not receive a majority of votes cast with respect to his or her election must

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[3] There is an exception if the public company already satisfies the majority voting requirement through its statute of incorporation, articles or by laws. TSX listed companies that are majority controlled are exempt from the TSX majority voting requirement. "Majority controlled" is defined as a security holder or company

immediately tender his or her resignation to the board. Within 90 days of the annual meeting, the board must decide whether to accept that resignation or, citing "exceptional circumstances", refuse to accept the director's resignation. The company must issue a news release announcing the board's decision. If the board has decided not to accept the resignation, the press release must set the reasons for that decision.

The TSX does not define "exceptional circumstances", but it has published a staff notice clarifying what, in the view of the TSX, constitutes "exceptional circumstances" to substantiate the board's decision to refuse to accept a director's resignation. In addition, TSX staff engages with a listed company if one or more of its directors has failed to receive majority support. This is discussed in greater detail in Section 4.2 below.

3. What is the problem that the federal government is seeking to address?

3.1 Is the majority vote of shareholders being respected now?

Is there an issue in the Canadian marketplace that needs to be addressed quickly with measures as significant as the changes being proposed by the federal government to the director election process for CBCA public companies? The data set out below argues that there is not. Shareholders express overwhelming support for the candidates proposed to them for election and when a director is voted down, he or she typically steps off. While there have been exceptions, early indications are that the TSX oversight of its majority voting requirements have been effective (with all directors who received sub-majority support stepping off their boards in 2016). The experience has been different in the U.S. It is much more common for a director to remain on the board even after being voted down by shareholders. As discussed in Section 19.1 below, majority voting is effected through by-laws and is not accompanied by any regulatory oversight.

The U.S. experience is not the Canadian experience. Our approach to majority voting should reflect the issues in our marketplace.

3.2 Canadian experience

The overwhelming majority of directors receive strong shareholder support in favour of their election. The following chart illustrates the average support level for all directors of S&P/TSX Composite Index companies for meetings held in 2015 and 2016.

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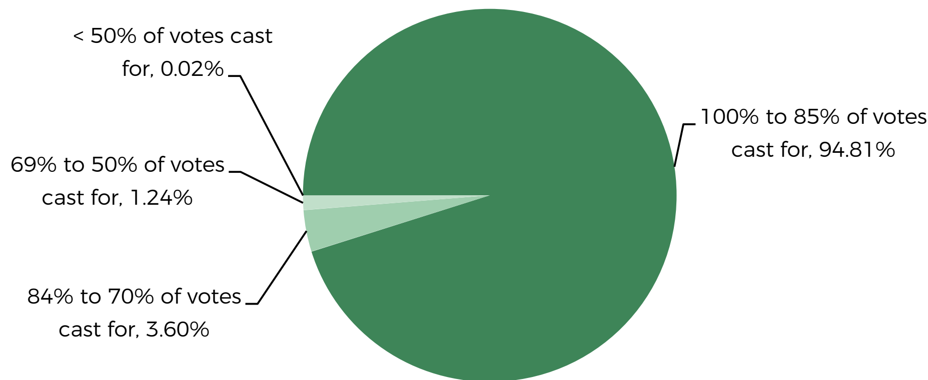
that beneficially owns, or controls or directs, directly or indirectly, voting securities carrying 50 % or more of the voting rights (of a class or series) for the election of directors, as of the record date for the meeting.

Director Election Support Levels

(S&P/TSX Composite Index, 2016 & 2015)



Source: SEDAR filings. S&P/TSX Composite Index composition is as of October 15 in both years.

Directors who continue to serve without the support of the majority of shareholders have been referred to as "zombie directors". This is not a common phenomenon in Canada. For meetings held in 2015 (the year majority voting became mandatory for TSX listed companies), we identified 23 directors at 11 companies who received sub-majority support. Of these, nine resignations were accepted by the board, leaving 14 directors across six companies who remained on the board without majority support at that annual meeting. Of these 14 directors:

- five stood for re-election in 2016 and received majority support
- four did not stand for re-election in 2016
- four were members of the board of a company that went into receivership before the next annual meeting
- one remained on the board until the completion of the company's ongoing strategic review (he served for seven more months before the company entered into a shareholder-approved plan of arrangement)

During the 2016 proxy season, five directors (at four companies) received sub-majority support in uncontested meetings. In each case, the director in question submitted his or her resignation immediately following the meeting, and those resignations were accepted by their respective boards.

3.3 U.S. experience

The experience in the U.S. in respect of overall number of directors who fail to receive majority support is largely similar to the Canadian experience. In 2016, only 47 uncontested directors (related to 28 companies) in the Russell 3000 Index failed to receive majority support for meetings. This represented less than 1% of the index.[4] The experience in 2015 was similar.[5]

However, the proportion of directors who remain on the board notwithstanding sub-majority support at the annual meeting is much higher in the U.S. than in Canada. Overall, from 2013 to October 26, 2016, 195 directors (at 104 companies) were voted down. Of these, only 36 directors (or 18%) left the board following the meeting (as of October 26, 2016). From 2011-2014, 85% of directors who were voted down by shareholders continued to serve on the board for at least two more years.[6] Accordingly to one study, companies provided little in the way of meaningful disclosure explaining to shareholders why the board had declined the director's resignation.[7]

4. Why move to deal with majority voting under corporate law instead of through the TSX?

The idea that an individual should not serve on the board of a public company if he or she has been voted down by the shareholders is broadly accepted as being the appropriate standard for TSX listed companies. The debate now focusses on how to impose majority voting as a requirement for public companies.

Institutional shareholders (particularly members of the CCGG) have been active proponents of amending the corporate statutes to require majority voting for public companies, rather than leaving responsibility for majority voting with the TSX. Other stakeholders in the capital markets community (including groups representing directors and issuers) have been consistently opposed to codifying majority voting in the corporate statutes. This section examines the two different perspectives on this issue.

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[4] Council of Institutional Investors, *FAQ: Majority Voting for Directors* (January 2017), online: <http://www.cii.org/files/issues_and_advocacy/board_accountability/majority_voting_directors/CII%20Majority%20Voting%20FAQ%201-4-17.pdf> ["CII Majority Voting FAQ"].

[5] Morgan Hrab and Glenn Davis, *Zombie Directors Still Haunt Boardrooms Despite New Era of Engagement, CII Governance Alert* (29 October 2015), online: <http://www.cii.org/article_content.asp?edition=4§ion=13&article=654 >.

[6] Hal Scott, "Op-ed: Public Companies' Unelected Directors" *Forbes Magazine* (21 December 2016), online: <http://www.capmktsreg.org/2016/12/21/op-ed-public-companies-unelected-directors/>.

[7] Ibid.

4.1 Majority voting as a fundamental shareholder right

Proponents of codifying majority voting in corporate law believe that the right of shareholders to determine who sits on the board by majority vote is so fundamental, it must be enshrined in corporate law (rather than the listing requirements of a stock exchange). The corporate law creates a single standard applicable to all public companies on which investors can rely. The majority rule principle outweighs the unintended consequences of majority voting that may range from inconvenience to significant adverse consequences for the corporation.

Proponents of codifying majority voting in stock exchange requirements see value in allowing the board to assess the impact of a shareholder vote on the corporation and to mitigate disruption and other unintended consequences. While the rule is that an individual who has been voted down by a majority vote of shareholders will resign and cease to serve as a director following the acceptance of the resignation by the board, "exceptional circumstances" may warrant an exception from the rule.

4.2 Board's decision to accept a director's resignation in "exceptional circumstances" is subjective

Board discretion to manage the timing of a defeated director's departure from the board has be an accepted feature of majority voting in Canada for many years. The CCGG's majority voting guidelines recommend that a majority voting by-law or policy include a provision to the effect that the board will promptly accept the resignation of a director who has not received a majority of votes in favour of his or her election"...unless it is determined that there are extraordinary circumstances relating to the composition of the board or the voting results that should delay the acceptance of the resignation or (in very rare cases) justify rejecting it".[8]

Stakeholders such as the CCGG who might otherwise see the value in allowing the board to keep a defeated director on the board in exceptional or extraordinary circumstances object to the lack of rigour around the definition of "exceptional circumstances" in majority voting policies adopted by TSX listed companies. The specific concern is that the circumstances on which TSX listed companies intend to rely in keeping directors on the board are not in fact exceptional and can be invoked to subvert the views expressed by shareholders. The most frequently cited example of this occurred in 2015, when the board of Québecor Inc. refused Michel Lavigne's resignation after receiving only 28% of votes in favour, citing his experience and contributions as a director.[9]

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[8] CCGG Policy: Majority Voting, March 2001. online: http://www.ccgg.ca/site/ccgg/assets/pdf/2011_MV_Policy.pdf

[9] Québecor Inc. announces election of directors, *News Release* (May 7, 2015), online: <http://www.newswire.ca/news-releases/quebecor-inc-announces-election-of-directors-517686871.html>.

The TSX has conducted an extensive review of the majority voting policies of its listed companies and has provided guidance with respect to the interpretation of its majority voting requirements. In its staff notice[10], the TSX notes that it does not generally consider the following factors with respect to a director to be exceptional circumstances, especially given that this information is typically available to shareholders when they make their voting decisions:

- length of service
- qualifications
- attendance at meetings
- experience
- contributions to the listed company

Based on this guidance, a board of a company such as Québecor could not easily refuse to accept the resignation of a director such as Mr. Lavigne for the reasons it cited.

The TSX has established a high threshold for "exceptional circumstances". In its staff notice, it provides the following examples of situations that may meet this threshold:

- situations where the director's departure would cause the company to be non-compliant with corporate or securities law requirements, or in breach of commercial agreements regarding the board's composition;

- situations where the director is a key member of an active special committee that has a defined term or mandate (such as a strategic review) and the director's departure would jeopardize the achievement of the special committee's mandate; or

- situations where majority voting was used for a purpose that is inconsistent with the policy objectives of the TSX majority voting requirement.

One can easily imagine other circumstances that would argue in favour of a defeated director remaining on the board for a period of time. For example, if a majority of the board were voted down by the shareholders (four of seven directors, for example), would it be in the best interests of the corporation to leave a skeleton board in place, with no successors to the departing directors in sight?

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[10] TSX Company Manual, Staff Notice 2017-0001, *Staff Notice to Applicants, Listed Issuers, Securities Lawyers and Participating Organizations* (9 March 2017), online: <http://tmx.complinet.com/en/display/display.html?rbid=2072&element_id=1082> ["TSX Majority Voting Staff Notice"].

Importantly, the TSX staff notice states that the TSX expects that an "exceptional circumstance" will not be a reoccurring event. If exceptional circumstances result in a board not accepting the resignation of a director who has been defeated, the TSX expects the company to take active steps to resolve the exceptional circumstance for the following year.

TSX staff is currently conducting another review of majority voting policies and has said that it will continue to monitor the effects of its majority voting on its listed companies and the marketplace. We anticipate that the TSX will continue to update its guidance on exceptional circumstances (whether by way of a further staff notice or as an amendment to its listing requirements).

However unlikely it is that a listed company would refuse to adopt a majority voting policy acceptable to the TSX (or then refused to comply with its policy), it is ultimately the judgement of the board that determines whether the circumstances it faces rise to the level of "exceptional", justifying a decision to keep a defeated director on the board. Directors must of course act in accordance with their fiduciary duty to the corporation in making these determinations. The guidance provided by the TSX and the experience being accumulated in the marketplace will inform these determinations. The proposition that, taking all of this into account, there is likely to be a problem in the Canadian marketplace with boards of directors ignoring the majority view of shareholders with respect to the election of a director is not supportable.

4.3 TSX majority voting regime has no teeth.

Critics of the TSX majority voting requirements argue that these requirements have no "teeth", because the TSX cannot force a director who has been rejected by the shareholders to submit his or her resignation or the board to accept it. While this is true, the TSX does have influence over its listed issuers. It is not a common occurrence for a TSX listed company to ignore a requirement such as the TSX's listing requirement relating to majority voting as well as the guidance provided by staff on the interpretation of that requirement and then finally to refuse to work with the TSX to resolve any outstanding issue. A director who refuses after being voted down by shareholders may find the TSX reassessing his or her suitability both for the board in question and for future boards of listed issuers on which that director may wish to serve.

4.4 Concern that the current majority voting regime does not have sufficient impact on the conduct of directors

Majority voting promotes the accountability of directors to the shareholders who elect them. It ensures that directors cannot serve following an annual election unless they are supported by a majority vote of the shareholders (subject to certain exceptions). Majority voting is also intended to have a prophylactic effect, encouraging directors to discharge their responsibilities in a manner that will be supported by a majority of shareholders or risk defeat at the next annual meeting. The theory is that if a director knows that he or she could be voted off the board, that director will take steps to ensure that shareholders see no reason to take such

action. Because it is possible for directors to remain on the board under the current TSX rules, even though they have been voted down by shareholders, the concern is that the TSX rules will not have sufficient impact on the conduct of directors.

Anecdotally, we know that directors pay careful attention to the support they receive from shareholders. Most directors know what percentage of "for" and "withhold" votes they received to the second decimal place. Academic research also suggests that a high level of shareholder dissatisfaction in director election results has negative consequences for the directors targeted by dissent, including facing reassignment away from leadership positions on important board committees. Shareholder dissatisfaction also leads to directors leaving the board altogether. A recent study of non-employee director elections for companies included in the Russell 3000 Index from 2003 to 2010 found that directors who received a 30% or more withhold vote were more likely to step off the board before the next annual meeting.[11] This study also reported evidence that a higher level of shareholder dissatisfaction against a director at one company is associated with a reduction in directorships at other companies.

Not all directors are the same, of course, and not every public company has a culture of respect for the views of the shareholders. For this reason, among others, it was necessary for majority voting to be regulated, the question being how it should be regulated.

4.5 Concerns with relying on stock exchanges to maintain a majority listing standard

4.5.1 Could the TSX simply revoke majority voting?

Critics of the current majority voting regime are concerned that the TSX could simply change or even revoke its majority voting requirement at any time. They argue that the TSX is primarily a for-profit entity and, despite its public interest responsibilities, it can choose at any time to amend its listing requirements to revoke the majority voting requirement.[12]

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[11] R., Aggarwal, S. Dahiya, and N.R. Prabhala, "The power of shareholder votes: Evidence from director elections" (2015) Georgetown McDonough School of Business Research Paper No. 2609532, online: <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2609532>.

[12] In its May 14, 2014 submission to Industry Canada re: Industry Canada Consultation on the *Canada Business Corporations Act*, the CCGG cited a Globe and Mail editorial dated February 18, 2014, which stated in part as follows: "The new TSX rule is a breakthrough in Canadian corporate governance, but the campaign is not over. The TSX is a private company: nothing has changed in the legal structure for director voting. The new standard will only apply however long and in whatever format the exchange chooses." Letter from Daniel E. Chornous, Chair of the Board of Governors, Canadian Coalition for Good Governance to Director General, Marketplace Framework Policy Branch, Industry Canada (14 May 2014), online: <http://admin.yourwebdepartment.com/site/ccgg/assets/pdf/Submission_to_Industry_Canada_May_14,_2014_re_~onsultation_Paper_on_the_CBCA_Final_signed.pdf>.

These concerns are not consistent with the way in which the regulatory oversight regime (described below) for exchanges works in Canada. In short, however, the TSX would need to engage in extensive consultation and ultimately secure the approval of the OSC in order to revoke its majority voting requirement. It is extremely unlikely that the OSC would permit the TSX to revoke its majority voting requirements, absent a similar requirement being adopted in legislation (corporate or securities) applicable to its listed issuers.

Exchanges operate under recognition orders from the securities regulators, which impose a number of terms and conditions related to governance, conflicts of interest, operational requirements and reporting obligations.[13] TSX Inc. (which operates the Toronto Stock Exchange), for example, is recognized as an exchange in Ontario under a recognition order issued by the OSC (the "Recognition Order"). Among other things, the Recognition Order requires that the TSX conduct its business and operations in a manner that is consistent with the public interest.

Exchanges must also adopt rules and policies that are designed to appropriately govern and regulate the operations and activities of its markets and participants.[14] The procedures that the TSX must follow in respect of the review and approval of its listing requirements are set out in its Recognition Order and include a broad consultation process.[15] Specifically, prior to the implementation of any public interest rule or significant change,[16] TSX staff will have engaged in preliminary discussions with OSC staff about the objectives of the proposed public interest rule. The TSX must then file a notice to OSC staff that fully describes the proposed public interest rule or significant change and discusses its expected impact on members, issuers, investors and the capital markets. The OSC (including staff and the executive) is highly involved throughout the process. The notice must be approved for publication by the OSC and market participants must be provided with an opportunity to provide comments for a period not less than thirty days. Upon review of public comments received, OSC staff may

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Further, in a Brief and testimony to the Standing Committee on Industry, Science and Technology in respect of Bill C-25, CCGG representatives noted that "nothing prevents [the TSX majority voting requirement] from being reversed in the future." Stephen Erlichman and Catherine McCall, Canadian Coalition for Good Governance Brief to the House of Commons Standing Committee on Industry, Science and Technology (16 February 2016), online: <http://www.parl.gc.ca/Content/HOC/Committee/421/INDU/Brief/BR8802920/br-external/CanadianCoalitionForGoodGovernance-e.pdf>.

[13] *Securities Act*, RSO 1990, c S-5 ["OSA"].

[14] National Instrument 21-101 *Marketplace Operation*, s. 5.3.

[15] Schedule 10 Process for the Review and Approval of Rules and the Information Contained in Form 21-101F1 and the Exhibits Thereto ["Schedule 10"].

[16] Pursuant to Schedule 10, a "significant change subject to public comment" means a significant change that, in Staff's view, has an impact on the Exchange's market structure or members, or on issuers, investors or the capital markets or otherwise raises public interest concerns and should be subject to public comment.

either provide material comments or request additional information to complete its review before making a recommendation to the Commission, which may approve or refuse to approve the public interest rule.

4.5.2 Will new exchanges create governance arbitrage by not requiring majority voting?

Some also note that the Canadian securities exchange industry is changing rapidly and the TSX is now facing competition from new exchanges for share listing and trading activity. For example, they point to the entry of Nasdaq Inc. into the Canadian equities market as a factor that will create competition for listings, particularly if Nasdaq is not subject to the same level of regulatory requirements as the TSX. It is premature for the purpose of this Discussion Paper to consider whether increased competition from new exchanges will influence companies to seek a listing where governance requirements are less rigorous. In any event, it is unlikely that the OSC would allow the ability for public companies to engage in governance arbitrage among senior exchanges.

Part II – The Federal Government's Proposed Approach to Majority Voting

5. How directors are elected now

This section describes the aspects of the director voting regime currently in place for CBCA public companies that are particularly important to the majority voting discussion.

5.1 Shareholders elect directors at the annual meeting

At the annual meeting, shareholders elect directors to replace those whose terms have expired (or fill positions that were not filled at the time of the last annual meeting). Although shareholders may elect directors for up to a three year term, it has long been the convention in Canada that directors serve for terms of one year. As a result, all of the directors stand for election or re-election each year.

Allowing for terms of up to three years leaves open the possibility of a "staggered board", with the terms of one-third of the directors expiring each year. This is a common practice in other jurisdictions (Australia, for example) because of the stability that it brings to the composition of the board. As noted above, staggered boards have never been common practice in Canada. However, they are used in the U.S. and are often seen as a take-over defence (since a board cannot be turned over at a single annual meeting). As a result, staggered boards are viewed negatively by many shareholders in North America. The TSX amended its listing requirements in 2012 to provide that TSX listed companies could not have staggered boards (although it makes exceptions for issuers for cross-listed issuers from certain international jurisdictions that have less than 25% of the overall trading volume of their listed securities occurring in Canada).[17]

5.2 How an election can fail

Few public companies (or private companies, for that matter) encounter the provision in the CBCA that effectively stipulates that an election is only valid if shareholders elect the required number of directors. If they do not elect the required number of directors, another shareholder meeting must be called so that shareholders may elect additional directors to get to the minimum number required (and so on until the minimum number of directors is in

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[17] The TSX requirement for annual director elections is also consistent with requirements imposed for TSXV listed companies. Section 19.6 of TSXV Policy 3.1 provides that TSXV listed companies should avoid mechanisms that entrench existing management such as staggered elections of the board of directors or the election of a slate of directors.

place). The directors who have been elected do not have the authority to transact business, other than calling a meeting of shareholders (except in the rare circumstances described below).

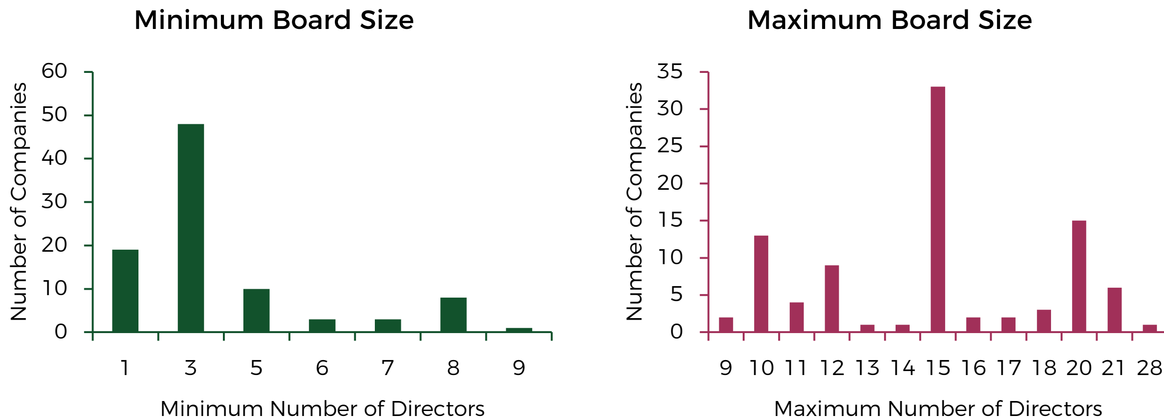
Under the CBCA, the required number of directors is (almost always) the minimum number of directors required by the corporation's articles. Public companies typically have a "floating board",[18] meaning that the articles set a range for the number of directors the corporation must have – a minimum of three and a maximum of 15 would be common, for example. In that case, shareholders must elect three directors; otherwise a new meeting of shareholders must be called to elect additional directors to reach the minimum number of three.[19]

If shareholders do not elect the required number of directors, we refer to the election as being a "failed election". We are aware of a few – but very few – situations in which shareholders have failed to elect the required number of directors, but the fact that this provision exists is important to the majority voting discussion.

The following charts illustrate minimum and maximum board sizes among S&P/TSX Composite Index companies incorporated under the CBCA. Three is the most common minimum and 15 is the most common maximum.

[18] Only one of the 92 CBCA companies included in the S&P/TSX Composite Index has a fixed board. All others have floating boards.

[19] The director election provisions of the CBCA are different from some other statutes. For example, the CBCA is quite different from the OBCA. Both statutes allow for floating boards. The OBCA gives shareholders authority to set the number of directors within the range set out in the articles of the corporation. The shareholders may (and typically do) delegate responsibility to the board to set that number. The CBCA is silent on how (or whether) the number of directors to be elected within the range is determined. There is no provision that gives the shareholders the authority to set the number. It may be that the directors have the authority to set the number, based on the residual authority to manage the business and affairs of the corporation.



CBCA incorporated companies that are S&P/TSX Composite Index constituents as of February 22, 2017. Source: Industry Canada filings.

In public companies, the incumbent board invariably proposes at least the required number of directors for election. As such, it is difficult to imagine how it would even be possible for public company shareholders not to elect that number. One scenario anticipated by the CBCA is that one or more of the candidates for election might pass away on the eve of the annual meeting. The shareholders might then not be in a position to elect the required number of directors (unless a valid nomination was made from the floor and approved). The CBCA anticipates this and other unusual situations (such as a candidate's name appearing in the proxy circular and on the form of proxy, even though the candidate did not agree to serve as a director). In the rare event that any of these situations occur, the directors who are elected may continue to transact business until the shareholders meet to elect the additional directors required to reach the minimum number required (provided that the directors who are elected constitute a quorum).

For the reasons discussed above, it is quite unlikely that a CBCA company would experience a failed election as a result of the amendments being proposed to introduce majority voting into the CBCA. Interestingly, if the same amendments were adopted under other corporate statutes, failed elections would be very likely. The reason for that is that, under other statutes, the shareholders (or directors through delegation from the shareholders) fix the number of directors who must be elected from within the range set out in the articles. If the shareholders do not elect the number so fixed, the election is not valid and a new meeting of shareholders must be called.

5.3 Directors are elected by a majority of votes cast (not by a plurality)

Although it is often said that directors in Canada are elected by a plurality of votes, that is not quite correct. Plurality voting typically means that the person who receives the most votes wins. The CBCA provides that directors are elected by ordinary resolution, which means that a director candidate is only elected if a majority of votes have been cast in his or her favour.

In closely held private companies, shareholders vote directly (that is, not by proxy), and may vote for or against a director candidate. A candidate must receive a majority of "for" votes in order to take office. In other words, the CBCA already provides for majority voting when shareholders do not vote by proxy (as is often the case for closely-held private companies).

It is the form of proxy that prevents shareholders from voting against a candidate for election. This is discussed in greater detail below.

5.4 Shareholders voting by proxy may only vote in favour of a candidate for election

5.4.1 The "for" vote

As noted above, the way in which shareholders cast their votes by proxy is determined by the form of proxy itself. The form of proxy used in Canada only allows shareholders to instruct the proxyholder to vote in favour of a director candidate shown on the ballot. There is no opportunity to vote against a candidate for election. Accordingly, all of the directors proposed by the incumbent board (and presented in the proxy circular and proxy) will be elected, provided that the election is uncontested and at least one person votes in favour of each candidate or the slate of candidates.

5.4.2 The "withhold" vote

Although, shareholders have the option of marking "withhold" on the proxy in respect of director elections, doing so has no impact on the outcome of those elections.

There was a time when the form of proxy in Canada (and in the U.S.) did not include a "withhold" box, since checking the withhold box had no greater impact than not voting at all. Ultimately, the "withhold" box was added, among other reasons, to encourage shareholders to send in their proxies with respect to other matters of business, without fear that leaving the "for" box blank would give the proxyholder license to act on the shareholders' behalf.

5.4.3 What is the purpose of voting if the director election is uncontested?

Why put shareholders through the charade of voting in an uncontested director election if their votes have no impact? Among other things, it is a question of timing. Public companies are required to provide shareholders with the opportunity to cast their votes by proxy, so that they will not be disenfranchised if they are unable to attend the shareholders' meeting. They must also provide shareholders with information about the individuals whom the board is recommending that the shareholders elect. At the time the proxy circular and form of proxy are sent to shareholders, the company will not know if the election will be contested, but the materials must still be sent out. In fact, since nominations may be made from the floor, it is not until the shareholder meeting is underway that it will be known whether the election will be contested. Successful nominations from the floor may be a remote possibility in widely

held public companies, but do occur in other situations. Smaller companies in the mining sector in Canada provide a good example – inspiring the adoption of advance notice policies and by-laws in recent years.

5.5 How shareholders use the withhold vote to have a practical impact on the outcome of elections

Beginning in the years following Enron, shareholders found a way to make the "withhold" option meaningful. One of the earliest examples in the U.S. occurred at the 2004 annual meeting of The Walt Disney Company ("Disney"). Michael Eisner, the then-Chairman and CEO of Disney, faced a wave of dissent in advance of the company's annual meeting that year. A number of shareholders were critical of the company's performance and Eisner's leadership in respect of the dismissal of Michael Ovitz, which was the subject of a shareholder derivative lawsuit. The board had also received a hostile take-over bid from Comcast Corporation three weeks before the annual meeting and two former board members publicly voiced their concerns about the company's leadership. Proxy advisory firms ISS and Glass Lewis recommended shareholders withhold their votes for Mr. Eisner's election and prominent institutional shareholder CalPERS announced that it had "lost complete confidence in Mr. Eisner's strategic vision and leadership in creating shareholder value" and would withhold voting for him.[20] At the meeting, Eisner received a 43% withhold vote. Disney's board responded by forcing Eisner to step down as Chairman. He left the company one year later, before his employment contract expired.

At the same time, institutional investors were becoming more engaged and a stronger voice in the governance of public companies. In Canada, the CCGG was formed in 2002 and majority voting quickly became one of its top priorities. It issued a model majority voting policy in 2006, which was adopted to a greater or lesser extent by Canadian public companies. Majority voting was adopted by Canada's public companies in response to shareholder proposals at first, but then was widely adopted by Canada's largest public companies. The "withhold" vote was used as a proxy for "against" and directors were expected to resign if he or she received a majority of "withhold" votes.

The commitment of shareholders to majority voting was tested at the first director election at Magna International ("Magna") after the collapse of Magna's dual class share voting structure in 2010. At the 2011 annual meeting, Magna shareholders voted for individual director candidates, but Magna had not yet adopted a policy of releasing the results of the votes. Three of Magna's shareholders (Canada Pension Plan Investment Board, RBC Global Asset Management and Connor Clark & Lunn Investment Management Ltd.) sued for the release of

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[20] Bruce Orwall, "CalPERS to Withhold Voting for Eisner", *The Wall Street Journal* (26 February 2004), online: <http://www.wsj.com/articles/SB107774511301139206>.

the results. When Magna did release the results, they showed that three of the directors had received the support of only 38% of the shareholders. None of the three directors stood for re-election at the next annual meeting.

5.6 Slate vs. individual director voting

Shareholders take action by way of resolution. There is no legal requirement setting out how that resolution should be framed – that is largely a matter of shareholder meeting protocol. For many years, the convention was that one resolution would be put before the shareholders, listing all of the nominees for election to the board (as opposed to a separate resolution for each candidate for election). This is referred to as "slate" voting. Since most director elections are uncontested, this was the most efficient way to run a meeting. It did not, however, allow shareholders to express their views about individual directors – by voting for one director and withholding a vote from another, for example.

One of the key features of majority voting is a requirement that shareholders have the opportunity to vote for each director individually. This provides the ability for the votes to be counted separately and the results reported out to shareholders. The CBCA does not currently mandate individual voting for directors, but proposes to do so as part of the amendments to the director election provisions of the CBCA. The TSX already imposes individual director voting on its listed companies, as does the TSXV.

5.7 Disclosure of results of director elections

Voting at a shareholder meeting takes place either by ballot or by show of hands. Securities law requires public companies (other than those listed on the TSXV) to disclose the results of the vote, but only if voting has been carried out by ballot (as opposed to by show of hands).[21] In concept this makes sense, because a show of hands may not be precise enough to do anything other than to allow the chair of the meeting to declare whether a resolution has passed or failed.

Shareholders of public companies typically vote by proxy and so by the time the meeting occurs, they have already cast their vote. The results of the meeting are therefore known even before the meeting begins. The show of hands is therefore largely ceremonial.

The CBCA does not require the corporation to disclose how many shareholders voted for a director candidate or slate and how many shareholders withheld their votes and the CBCA Amendments will not impose this requirement. However, the TSX imposes this requirement on its listed companies.

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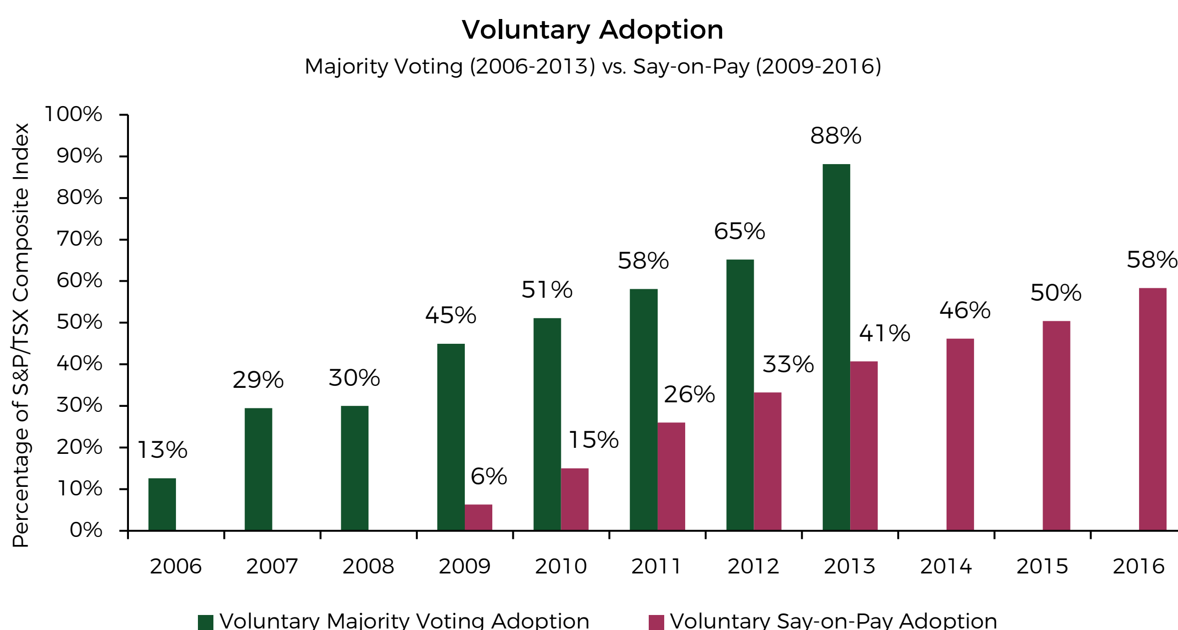
[21] National Instrument 51-102 *Continuous Disclosure Obligations*, s. 11.3.

5.8 The TSX approach to majority voting

As noted at the outset of this Discussion Paper, majority voting was adopted by several public companies in 2006 as a result of shareholder proposals, leading to voluntary adoption by almost two-thirds of companies listed on the S&P/TSX Composite Index by 2012.

The illustration below shows the pace at which Canadian public companies adopted majority voting. The progress was steady but slow (albeit somewhat more aggressive than voluntary adoption of say on pay has been). This accounts for at least some of the frustration institutional shareholders represented by the CCGG have expressed and the reason for the concerted push for codification of majority voting in corporate statutes.



S&P/TSX Composite Index composition is as of October 15 in each year. Source: Clarkson Centre for Business Ethics & Board Effectiveness.

In 2012, the TSX adopted majority voting on a "comply or explain" basis, resulting in the spike in voluntary adoption from 2012 to 2013.[22] By 2014, majority voting had become a TSX listing requirement (in the form of the TSX majority voting requirement discussed in this paper).

[22] The "comply or explain" amendments required a TSX listed company to disclose in its management information circular on an annual basis whether it has adopted a majority voting policy for uncontested director elections and, if a policy is not adopted, explain its practices for electing directors and say why it has not adopted such a policy.

The TSX majority voting requirement provides that each director must be elected individually for a one-year term and by a majority (50% + 1) of the votes cast "for" with respect to his or her election at an uncontested meeting. It also requires TSX listed companies to adopt a policy[23] that provides that a director who does not receive a majority of votes cast with respect to his or her election must immediately tender his or her resignation to the board. That policy must require the board to determine whether to accept or refuse to accept the director's resignation within 90 days of the meeting. The director who submitted a resignation cannot participate in any meeting of the board or any sub-committee of the board at which the resignation is considered. The board shall accept the resignation absent "exceptional circumstances."[24] The resignation is effective when accepted by the board. The public company must also promptly issue a news release announcing the board's decision and, if the board determines not to accept the resignation, the news release must fully state the reasons for that decision.

TSX staff is actively engaged in overseeing compliance by its listed companies with its majority voting requirements. TSX staff contacts each listed company that has reported that a director has failed to receive majority support to understand the circumstances of the votes and confirm that the board has an appropriate majority voting requirement. Where TSX staff has identified deficiencies or inconsistencies with the policy objectives of the TSX majority voting requirement, it may request that the listed company make changes to its majority voting policy to comply with the TSX majority voting requirement.

The TSX also recently published a staff notice to provide guidance in respect of the TSX majority voting requirement.[25] The TSX expects any director not elected by a majority of votes cast to immediately tender his or her resignation to the board. Failing to so would be in breach of the TSX listing requirements, which may cause the TSX to review the director's suitability to be involved as a director, officer or other insider of TSX listed companies. Moreover, the staff notice provides guidance clarifying what, in the view of the TSX, constitutes "exceptional circumstances" to substantiate the board's decision to refuse to accept a director's resignation. This is discussed in greater detail below.

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[23] There is an exception if the public company already satisfies the majority voting requirement through its statute of incorporation, articles or by-laws. TSX listed companies that are "majority controlled" are exempt from the TSX majority voting requirement.

[24] The TSX majority voting requirement does not define "exceptional circumstances".

[25] TSX Majority Voting Staff Notice, *supra* note 8.

6. How the federal government is proposing to change director elections

6.1 Shareholders would be entitled to vote against candidates for election in an uncontested election

The federal government is proposing to change the form of proxy used by public companies governed by the CBCA. Rather than having the option to mark "for" or withhold on their proxy vote, shareholders will have the option of voting "for" or "against" a candidate. If the election is uncontested (that is, if there is only one candidate nominated for each position on the board), a candidate is only elected if a majority of the votes cast are in his or her favour.

CBCA companies would still look to National Policy 51-102 for the form of proxy (as prescribed by the regulations to the CBCA), but would then look back to the CBCA regulations for the additional requirement for uncontested elections.

6.2 One year terms would be mandatory

The terms of directors would be restricted to one year – in other words, they must be elected annually. This mirrors the TSX current requirement in the TSX majority voting requirement and similar requirements currently applicable to TSXV listed companies. As noted above, staggered boards have never been common in Canada in any event.

6.3 Directors would have the authority to appoint additional directors (up to one third) unless shareholders preclude that authority

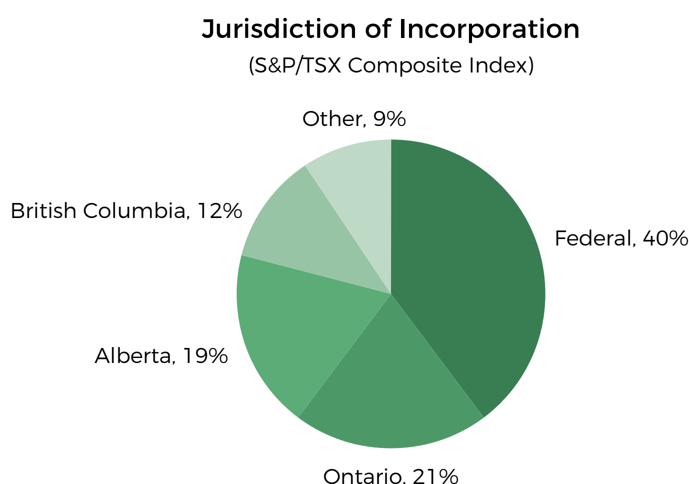
A board of directors would be entitled to increase the number of directors by up to a third of the number of directors who were elected at the last annual meeting. Currently, companies are permitted to put this provision in their articles (and typically do). This change will align the CBCA with common practice. Beyond that, it is a necessary change in order to ensure that the board has the ability to bring itself back up to (or close to) full strength if some of the candidates it has put forward have been defeated.

Part III – What the Federal Government's Approach to Majority Voting Will Mean

This part of the Discussion Paper considers what these changes will mean to public companies governed by the CBCA and to the Canadian capital markets in more generally

7. The significance of the federal government's proposal

Changes to the director election provisions of the CBCA will affect 40% of corporations on the S&P/TSX Composite Index[26] Those companies will be required to deal with these issues as early as the 2018 proxy season.



S&P/TSX Composite Index constituents as of February 22, 2017. Incorporation information is based on public disclosure. A total of 15 companies have been excluded from the above figures, including companies incorporated internationally and companies incorporated under legislation exclusively applicable to banks and insurance companies.

In addition, these changes will affect not just public companies governed by the CBCA, but the capital markets more generally. Investors in Canadian companies will need to distinguish between those public companies governed by the CBCA and those public companies governed by other Canadian statutes in determining how to exercise their rights in director elections. Votes will need to be tabulated differently for CBCA director elections than for non-

[26] As of February 22, 2017, the S&P/TSX Composite Index includes 248 listed companies, representing 95% of the total capitalization of the TSX listed companies.

CBCA elections. The complication that will result from differences in director elections across various Canadian jurisdictions is likely to lead to confusion and voting errors.

Complication also adds costs. Even if a well informed Canadian marketplace is able to deal easily with differences in directors' elections across jurisdictions, international investors will see a governance complication in investing in Canadian public companies. Any impact this has on the ability of Canadian companies to raise capital should be weighed carefully against the benefits of moving from the majority voting regime currently in place to the process set out in the CBCA Amendments.

8. Amendments will not result in "true majority voting"

The amendments being proposed to the CBCA would bring us closer to binding (or "true") majority voting than the current TSX regime, but they still involve a compromise to accommodate certain policy priorities that rank ahead of shareholder democracy in the view of the federal government. Specifically, the board would have the authority to appoint a defeated director to the board if that were necessary in order to ensure that the board would have the requisite number of resident Canadians or outside directors required by the CBCA.

A board comprised of five to eight directors must include two resident Canadians. If a board has the minimum number of resident Canadians and one of them is voted down by shareholders, it will be open to the board to reappoint the defeated director if the board considered that appointment necessary in order to meet the Canadian residency requirements. What "necessary" means in not defined in the amendments being proposed by the federal government and so that determination would be left to the board. There would be no oversight of the board's determination of what "necessary" meant in a particular context (in contrast to the oversight of the TSX of a board's determination of "exceptional circumstances). A shareholder's recourse would be to sue the company.

9. The ability of the board to function if some candidates are voted down.

9.1 No reason to expect a change in shareholder approval of director candidates

Over the past decade, shareholders have used the "withhold" vote to send a message to boards or individual directors on a variety of topics, including governance, executive compensation, financial reporting, director attendance and overboarding. Still, it has been unusual for a director to receive a majority withhold. There is no reason to think that directors would suddenly be voted off boards in large numbers if shareholders had the option to vote against a director candidate, instead of simply withholding the vote.

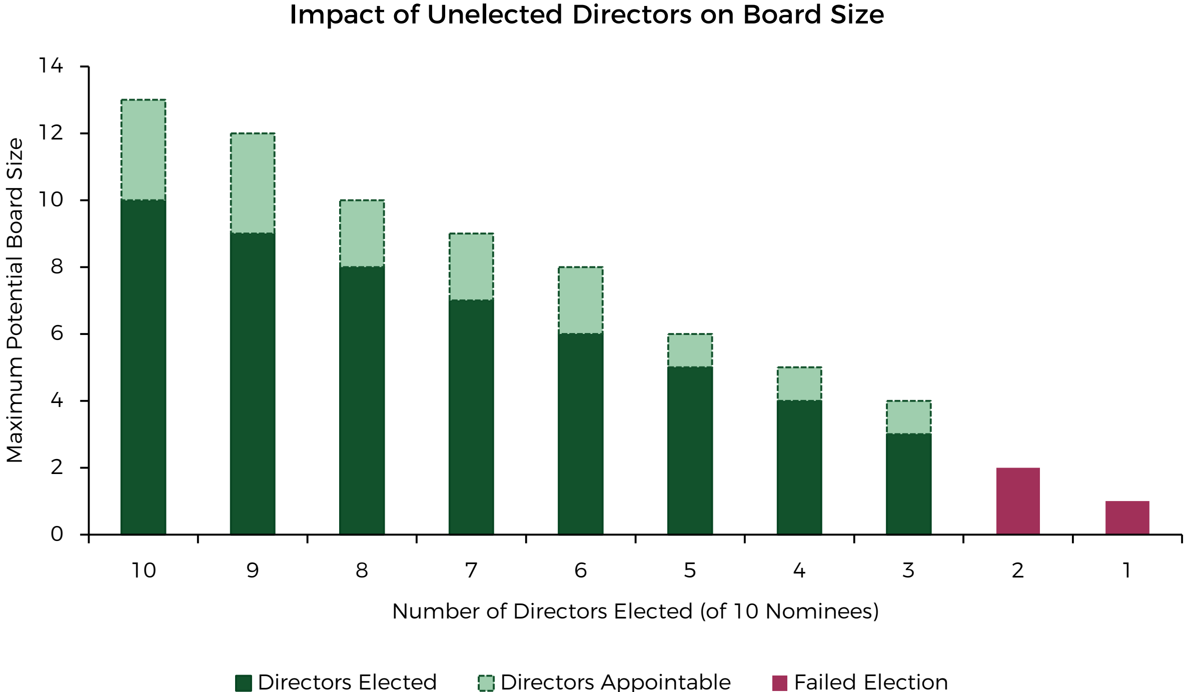
As proxies are submitted in advance of an annual meeting, the company will develop an understanding of whether one or more of the directors is likely to be voted down. Companies may choose to adjourn the meeting in those circumstances in order to meet with shareholders to resolve issues of concern to them, or to identify candidates for the board that would be more acceptable to them. If Canadian courts follow the reasoning set out in recent Delaware decisions, shareholders may be able to successfully resist this approach.

9.2 Failed elections unlikely

If a candidate does not receive a majority of "for" votes, that director would not be elected. The rest of the director election process would remain unchanged. In other words, if at least the minimum number of directors is elected, the election is valid. If less than a minimum number of directors is elected, then the election has failed and another shareholder meeting must be called. If the minimum number of directors required under the articles is three, for example, then there would only be a failed election if fewer than three directors were elected.

9.3 Board will have the authority to appoint a limited number of additional directors

If a director candidate is voted down, the board will not have the authority to appoint someone to fill that position. However, the board will have the ability to appoint additional directors – up to one third of directors then in office. As illustrated below, if 10 nominees were put forward and only eight were elected, the board could appoint two additional directors, bringing the total board size up back up to ten.



Assuming a minimum board size of three directors, which minimum is used by a majority of federally incorporated S&P/TSX Composite Index constituents. Red values indicate a failed election.

If a majority of directors are still in office, the board may continue to transact business. In most cases, quorum is set in the company's by-laws (and is most commonly either 50% or a majority of directors then in office). Thus, the smaller the number of directors then in office, the smaller the number of directors who will be required for a quorum (and who will be able to transact business on behalf of the company). Using the chart above, if the incumbent board of a public company put forward 10 director candidates for election to the board, but three directors were not elected to the board as a result of majority voting, four of the remaining seven directors would be able transact business. While boards may be able to retain independent outside advisors to provide support in the context of a smaller board, these outside advisors will not be subject to the director's fiduciary duty to the corporation and cannot take part in the board's decision making.

9.4 Directors voted down may not be appointed by the board

The directors who have been defeated in a director election will be "red-circled"; they cannot rejoin the board unless they are elected by shareholders. In other words, the board cannot circumvent the wishes of the shareholders by appointing the defeated candidate.

The federal government has provided two exceptions to the provision that a defeated director cannot be reappointed by the board. These exceptions allow a company to quickly remedy any lack of compliance with other CBCA requirements as a result of a shareholder vote. Even though a director has been rejected by the shareholders, that director may be appointed by the board if the appointment is "required" in order to meet the CBCA requirements that at least 25% of directors be resident Canadians (see discussion in Section 8) and that at least two of the directors of public companies shall not be officers or employees of the company or its affiliates.

9.5 Challenges in identifying new directors on short notice

Directors are not fungible. It has long been an important aspect of governance that boards be constructed thoughtfully. Skills matrices, board succession planning and board evaluations are just some of the tools used to put an effective board in place. Identifying the right candidate requires careful consideration of his or her skills, experience, existing commitments and availability to serve for an appropriate period of time. It also requires consideration of the board's culture and dynamics, and whether the candidate will be a good cultural fit. While it is true that there are many people who are prepared to serve on public company boards, the selection of a candidate who will add value to the work of the board is not quite so straightforward.

Some note that boards should have an "evergreen" list of potential board candidates in place in order to be able to respond to sudden vacancies on the board. While many boards have

adopted this practice, good director candidates are in high demand. The fact that an individual's name has been placed on a list of potential candidates by a public company board does not necessarily mean that the individual has agreed to serve or that he or she will be available on a moment's notice.

For most companies, the board recruitment process takes many months, even years. The directors first agree on the attributes of a director they need to add, then must identify and evaluate appropriate candidates, meet with a short list of candidates and then extend an invitation to the preferred candidate. They may do this with or without the assistance of a search consultant. Faced with the need to replace certain key skills, a reduced board may not have the luxury of engaging in the months long process to find the ideal candidate and so may be forced to adopt a rushed process. Some boards may find it expedient to appoint someone to the board who will only serve until the next annual meeting, giving the board more time to identify and recruit the best possible candidates.

9.6 Risk of compromised board effectiveness

A reduced board may not be able to exercise its oversight function effectively, resulting in decisions being made that would have benefitted from greater board scrutiny than is possible with a reduced board.

In some cases, a reduced board may not be prepared to make material decisions until its ranks have been expanded to include all of the skills they believed were necessary in proposing the candidates set out in the proxy circular.

9.7 Loss of flexibility in appointing additional directors

Boards of CBCA corporations are currently able to appoint additional directors, up to one third of the number of directors who were elected at the annual meeting (if provided in the company's articles). When this provision was introduced into the CBCA, the purpose was to provide the board with flexibility between annual meetings. If this provision must be used to bring the board up to full strength as a result of directors being voted off the board, the flexibility that the provision was originally intended to afford to directors will be lost.

10. Potential for pushing companies offside their regulatory requirements

The composition of the board of directors of a public company governed by the CBCA is also governed by a number of securities law requirements and recommended practices that go far beyond what is required in the CBCA. The amendments to the director election provision of the CBCA have the potential to push the composition of the board offside these requirements and recommended practices for whatever period of time it takes for the board to recruit new directors with the characteristics necessary to put the board back onside.

10.1 Independence

Securities regulators recommend that at least a majority of directors be independent, with the concept of "independence" going beyond corporate law to capture any material relationship with the company. Institutional shareholders prefer to see at least two thirds of the board comprised of independent directors. It is very common for large public companies to be comprised entirely of independent directors, with the exception of the CEO. If sufficient independent directors were voted off the board such that less than a majority of directors were independent, shareholders would presumably expect the board to use its ability to appoint additional directors to increase the complement of independent directors on the board.

The TSX and TSXV also impose director independence requirements for their listed companies. Companies are required to have at least two independent directors. However, given that these requirements are less rigorous than those set out in securities regulation, it would be less likely that they would be breached.

10.2 Audit committee requirements

The proposed amendments may leave a public company without an audit committee that meets the composition requirements under the CBCA and under securities legislation. However, lack of compliance with the CBCA can be remedied more easily than lack of compliance with securities, as discussed below.

The proposed regulations relating to majority voting allow the board to reappoint a defeated director if necessary to those requirements. The CBCA requires a public company to have an audit committee composed of not less than three directors. A majority of the audit committee may not be officers or employees of the company or any of its affiliates. If the company is offside these requirements because a shareholder vote leaves the company without sufficient directors that meet this independence test, the proposed regulations would allow the board to appoint one of the defeated directors who meets this standard of independence.

The independence standard for public companies listed on the TSX (as set out in securities regulation) is much higher. If a company could not comply with this standard following an annual meeting and no defeated director who met the CBCA standard of independence also met the standard of independence for the purposes of securities law, the company would need to recruit a new director who met the securities law standard. It would be offside it's obligations for securities law purposes until that new director joined the board (and the audit committee).

10.3 Foreign private issuer status

A public company could cease to qualify as a foreign private issuer in the U.S. if the board loses a majority of directors who reside outside the U.S.[27] Losing foreign private issuer status would result in the public company no longer benefitting from various exemptions under U.S. securities law. For example, foreign private issuers are subject to less onerous continuous disclosure obligations under U.S. securities law and may rely on special exemptions for raising capital in the U.S.

10.4 Potential to trigger change in control provisions.

A sudden change in the board pursuant to the amendments being proposed could trigger change in control provisions under employment and other agreements.

Most executive employment agreements define a "change in control" to include mergers, acquisitions, liquidations or changes in the control of the board (through a proxy contest or otherwise). We have reviewed a number of changes in control provisions in employment agreements. The definition of a "change in control" from the employment agreement of the CEO of a S&P/TSX 60 Index company includes the following event:

> "For the purposes of this Agreement, "Change in Control" shall include any of the following:
>
> Within any period of two consecutive years, individuals who at the beginning of such period constituted the Board of Directors of the Corporation and any new directors whose appointment by the Board or nominated for election by shareholders of the Corporation was approved by a vote of at least a majority of the directors then still in office who either were directors at the beginning of the period or whose appointment or nomination for election was previously so approved, cease for any reason to constitute a majority of the Board."

Similarly, credit agreements and indentures frequently include change in control provisions, which are intended to protect lenders from changes in the governance of the company (as the borrower) that might affect the company's credit quality. For public company borrowers, change in control provisions in credit agreements are frequently defined to provide that a change in control occurs when "continuing directors" cease to constitute a majority of the board of the borrower. In some cases, the term "continuing directors" is defined to mean person who were members of the board on the date of the agreement or replacement directors who were nominated (or whose election was approved) by a majority of the directors

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[27] For example, a CBCA incorporated public company will qualify as a foreign private issuer if 50% or less of its outstanding voting securities are held by U.S. residents; or if more than 50% of its outstanding voting securities are held by U.S. residents and none of the following three circumstances applies: the majority of its executive officers or directors are U.S. citizens or residents; more than 50% of the issuer's assets are located in the U.S.; or the issuer's business is administered principally in the U.S.

who were either members of the board on the date of the agreement or whose nomination (or election) was previously approved.

While many change in control provisions would not be triggered by the CBCA Amendments, CBCA companies and the parties with whom they contract will need to review existing and future provisions carefully if the CBCA Amendments come into force to ensure that provisions will not be triggered in circumstances other than those intended by the parties to the contract.

11. Changes to the board without a proxy contest

The CBCA Amendments give rise to the possibility of a change in the board being achieved through a majority voting campaign, rather than through a proxy contest. For example, a "vote no" campaign could be aimed at directors who are seen to be unsympathetic to the views of a particular shareholder or group of shareholders. The directors who remain will be in a position to either operate the board with a reduced size or to appoint other like minded individuals to the board.

An activist strategy of this nature may be unlikely in large companies; however, smaller companies with lower voter turnout and one or two larger shareholders may have greater reason to consider this scenario.

12. How companies should respond

12.1 Getting the vote out

The possible adverse consequences of sudden death elections will make it more important for public companies to take steps to encourage shareholders to vote. Sudden death elections will increase the influence of every vote cast. In a small company with lower voter turn out, a holder of less than 10% of the shares could determine the outcome of a director election. Increased costs to retain proxy solicitors to mitigate this possibility may present challenges, particularly for smaller issuers with limited resources.

One of the most significant challenges is, of course, that public companies often do not know who their shareholders are. They have no means of identifying or communicating with beneficial shareholders who have identified themselves as OBOs (or objecting beneficial owners). Moreover, beneficial shareholders may elect to receive materials for all meetings, special meetings only or no meetings at all. The company will have no contact at all with beneficial shareholders (often retail holders) who have elected not to receive materials for annual meetings and have therefore decided to forego their right to vote for the election of directors. The fact that the company cannot communicate with many of its shareholders and many shareholders have abandoned their right to vote without knowing what the issues might be creates challenges for companies seeking to secure a vote that is fairly representative of its shareholder base.

12.2 Put a crisis management process in place

Public companies governed by the CBCA will need to plan for unexpected results of an annual meeting, including the need to recruit directors with specific skill sets on short notice. The nominating committee should be ready with a plan that can be implemented immediately. That plan should deal not only with recruitment issues, but should also include communication with stakeholders (including regulators) and a review of contracts that might be effected.

12.3 Review contracts

Management of public companies governed by the CBCA should take a fresh look at the change in control provisions in employment, credit and other agreements to determine whether majority voting could trigger those provisions. Management should also be alert to this issue when negotiating new contracts.

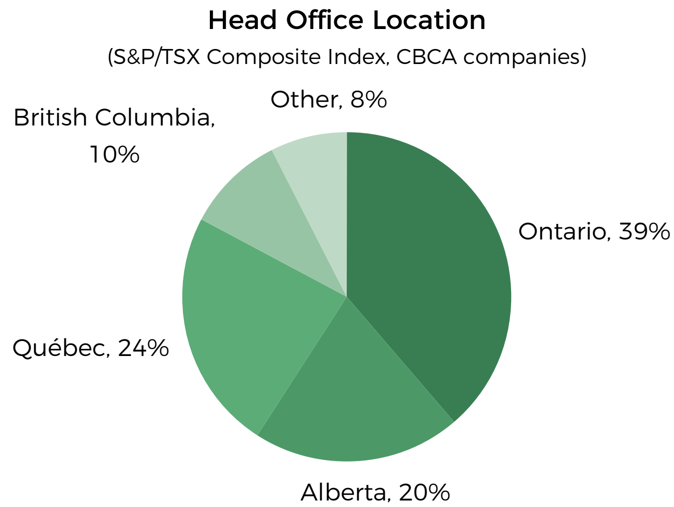
12.4 Review the minimum number of directors

Public companies and their shareholders should consider whether the company has an appropriate minimum number of directors. Where the minimum is three, for example, as is the case for many public companies, there is little likelihood of a failed election. However, where a significant number of directors are voted off the board, the company could be left with a board that is much smaller than is desirable.

12.5 Consider a change in jurisdiction

Companies governed by the CBCA could also consider continuing into another jurisdiction. It might make sense to continue into the jurisdiction where the company's head office is located (typically Ontario, Quebec or Alberta), for example. It is not uncommon for public companies to continue into a jurisdiction with more flexible corporate statutes (British Columbia, for example, because it's corporate statute does not include a residency requirement for directors).

It is a relatively simple matter for the company to move to another Canadian jurisdiction. However, it does require shareholder approval, which shareholders may be reluctant to give if majority voting is a priority for them.



Source: SEDAR filings. S&P/TSX Composite Index constituents as of February 22, 2017.

A more likely consequence may be that businesses that plan to go public will choose to incorporate in jurisdictions such Alberta, Ontario, Québec or British Columbia if they consider the majority voting provisions of the CBCA to be too draconian.

Part IV – Developing an Approach to Majority Voting Appropriate for the Canadian Marketplace

If the way in which directors are elected in Canada is to be changed, it should be changed in a way that is most appropriate for our marketplace. We have set out below some considerations that should inform the approach to majority voting in Canada. We have also proposed some alternative approaches that would meet the objectives of "binding majority voting" without the risks inherent in the changes to the CBCA being proposed by the federal government.

13. Understanding our own marketplace

13.1 Retail vs institutional investors

Public companies raise capital from both retail (i.e., individual) and institutional investors. High level estimates of how securities are held have been offered by regulators, [28] but are not granular enough to draw conclusions that would inform this Discussion Paper, but more detailed information is not publicly available.

Retail investors account for a portion of TSX's market capitalization and based on the activities of proxy solicitors working on one side or the other of a contested shareholder vote, it is reasonable to assume that their votes have some impact. Are the interests of retail investors necessarily the same as the interests of the institutional investors on all governance issues? It is generally thought that retail shareholders are much less likely to vote than institutional shareholders (in many cases because they do not believe that their vote will make a difference). As noted in Section 12.1, shareholders may elect not to receive materials relating to annual meetings and so may forego the opportunity to vote for the election of directors. We do not know, of course, whether this is because they assume that the candidates proposed by the incumbent board will always be elected (and that they are happy with this result for so long as they own the shares) or because they prefer to have more actively engaged shareholders make the decision for them.

Further research on the shareholder composition of our capital markets is important in order to understand the dynamics of our marketplace.

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[28] The OSC estimates that the holdings of retail and institutional investors are about even in terms of market capitalization with retail investors representing 49% of TSX market capitalization and 52% of the S&P/TSX Composite Index. It also estimates that institutional investors hold approximately 33% of all outstanding shares of TSX listed companies Ontario Securities Commission, *Closing Remarks by Maureen Jensen to Shareholder Rights Conference University of Toronto* (28 October 2016), online: <http://www.osc.gov.on.ca/en/NewsEvents_sp_20161028_rights-conference.htm >.

13.2 All institutional investors are not the same

Institutional shareholders (like all shareholders) come to their investments with many different motivations. The Canadian marketplace has the benefit of a number of large institutional shareholders who work together as part of the CCGG. They are thoughtful about governance and are interested in the sustainability of the public companies in which they invest. They value directors who take a long term perspective for the company.

Other institutional shareholders may have a more short term perspective on their investments in public companies. In some cases, they look for an opportunity to influence change in governance or strategy to surface a short term gain before they exit the investment. Whether this is good or bad for all shareholders or for the company will depend on the situation. For the purposes of this Discussion Paper, it is important only to note that all institutional shareholders do not have the same priorities.

13.3 TSX companies vs TSXV companies

Issuers listed on the TSXV represent 69% of the total number of entities listed on the TSX and TSXV combined, but only 1.47% of the total market capitalization of the two exchanges. They are typically early stage companies which have limited resources. Some governance requirements set out in securities regulation do not apply to venture issuers because securities regulators have recognized that the burden of compliance would be too great for such small companies. However, the TSXV itself performs extensive oversight of the governance of TSXV issuers, including closely reviewing directors, officers and other individuals involved or proposed to be involved with the company.

Public companies listed on the TSXV (often referred to as "venture issuers") generally have more concentrated share ownership and lower shareholder participation at annual meetings. These factors could be significant if shareholders, a relatively small percentage of the shares (8%, for example), vote against certain directors, in order to gain control of the board. In these circumstances, it will not be apparent whether the lack of support for a particular director reflects the views of a majority of shareholders, or just a majority of a small number of shareholders who are peculiarly motivated to vote certain directors off the board. The cost of retaining proxy solicitors in order to ensure that the shareholder vote fairly represents the views of the company's shareholders may be prohibitive for companies that already have limited resources.

TSXV listed companies also generally have smaller boards, increasing the risk of loss of necessary skills, experience and independence caused by the non-election of directors who failed to receive majority support.

The TSXV has considered majority voting and has determined that it is not appropriate for its listed companies. The TSXV should be consulted and the venture issuer community should have an opportunity to comment before changes that the TSXV has already rejected are

imposed on its listed companies. Although the CBCA is not the statute of choice for venture issuers in any event, the CBCA should not be amended in a way that makes it distinctly unattractive for companies operating in a portion of Canada's economy.

14. Leveraging our successes in governance regulation

14.1 The value of a single Canadian approach

It is not optimal for director election regimes to be different across various Canadian jurisdictions. That is one of the advantages of the TSX majority voting requirement – all TSX listed companies are subject to the same requirements. This is much less confusing for investors, particularly international investors considering investing in the Canadian marketplace. A fragmented approach to director voting across jurisdictions increases the costs of investing in Canadian companies (because of the need to track director election provisions for various investments) and may make it difficult for some shareholders to exercise their voting rights effectively. We discuss the merits of rethinking the lines between corporate law and securities law with respect to public company governance below. At this juncture, we note that if public company governance fell within the authority of the securities regulators, a coordinated approach would be much more likely.

14.2 Resisting the temptation to import U.S. problems

Much of our awareness of governance problems comes from the U.S. In determining whether changes should be made in our director election process, we should consider the problems present in our marketplace, as opposed to those we hear of from the U.S.

As noted in Section 3.2, we have very few examples of directors receiving a majority of withhold votes under our current system. There is little evidence that Canadian boards are likely to keep directors in place if they have been voted down by shareholders. This did not happen even once in the last proxy season. We should not be regulating to prevent a problem that doesn't exist and is not likely to develop.

14.3 Building on the success of market standards in corporate governance in Canada

Canada has a long history of success with non-regulated changes in corporate governance. The comply or explain regime for corporate governance (first introduced by the TSX in 1995 and now housed in National Policy 58-201) raised the bar for governance in Canada and is widely accepted as the baseline of Canadian governance.

It was important to regulate majority voting in Canada in order to impose a common standard on all TSX listed companies. However, the "exceptional circumstances" that may make it appropriate for a director to remain on the board for a period of time after he or she has been defeated should develop organically. Assuming that the TSX continues to monitor the actions

of boards in dealing with directors who have been defeated at the annual meeting, there seems little risk (based on the experience in Canada to date) that this would give rise to problems.

15. Other ways to codify majority voting

We suggest that stakeholders in the corporate director election process should consider whether any change to corporate statutes is required (immediately, or at all). The TSX majority voting requirement addresses 98.53% of the quoted market value of the Canadian capital markets. There have been minimal issues and problems presented by the TSX majority voting requirement. The Institute of Corporate Directors supports this alternative, stating that the TSX majority voting requirement provides an effective framework for Canada's largest companies and real consequences for directors who fail to receive majority support.[29]

However, the desire on the part of many institutional shareholders to see their right to determine who sits on the board enshrined in the corporate statute is an important policy issue. If Canadian corporate statutes are amended to incorporate majority voting, an approach that could be supported by all jurisdictions should be explored. We have set out below some alternative approaches to codifying majority voting.

15.1 Avoid disruptive of sudden death elections

Directors who do not receive a majority of votes cast in favour should be entitled to remain on the board until a replacement has been identified. The "hold period" would allow the board the flexibility needed to deal with the circumstances of the vote and manage its internal affairs by delaying the departure of defeated directors for a reasonable period of time until their replacements are in place.

15.2 Effect majority voting through by-law amendments

Consistent with the approach taken in the U.S., the CBCA could give corporations the flexibility to set the standards for director elections in its articles or by-laws. For example, recent amendments to the *Business Corporations Act* (Québec)[30] provide that directors are elected "in the manner and for the term, set out in the by-laws", and thus should allow for the adoption of a majority voting standard.

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[29] House of Commons, Standing Committee on Industry, Science and Technology, 42nd Parliament, 1st Session (16 February 2017) at 845 (Matthew Fortier), online: <http://www.parl.gc.ca/HousePublications/Publication.aspx?Language=e&Mode=1&Parl=42&Ses=1&DocId=8775921#Int-9379915>.

[30] *Business Corporations Act* (Québec), CQLR c S-31.1, s 110.

There is some precedent for dealing with director election matters in articles and by-laws. Nortel Networks Corporation, adopted articles providing that directors be elected by a resolution passed by not less than two-thirds of the votes attaching to shares represented in person or by proxy. While this was done for corporate and tax structuring reasons[31] as opposed to being a harbinger of an emerging governance trend, it serves as a useful example.

The board of Nexen Inc. adopted a by-law amendment to provide for a modified majority voting standard for director elections in 2006. Nexen described the by-law amendment in its management proxy circular for the 2007 annual general and special meeting of shareholders as follows:

> A director who does not receive a majority of the votes cast in favour of his or her election must submit a resignation to the board for consideration. The independent members of the board, on the recommendation of the Governance Committee, determine whether or not to accept the resignation. In considering whether or not to recommend acceptance or rejection of the resignation, the Governance Committee will evaluate the best interest of Nexen and its shareowners and consider a number of factors including any alternatives to cure the underlying cause of the withheld votes, the skills and attributes of the director and the overall composition of the board, including the current mix of skills and attributes of the board, and whether accepting the resignation would cause Nexen to fail to meet any applicable listing or regulatory requirement. Nexen will promptly disclose in a press release the decision of the independent directors and an explanation of how the decision was reached. In the case of a contested election, a plurality standard, which would have those directors who receive the most votes elected, would continue to apply.[32]

Dealing with majority voting in the company's articles or by-laws the company and its shareholders gives both shareholders and the board the ability to refine the company's approach to majority voting to best suit the company's circumstances and governance context. The CCGG has endorsed majority voting provisions in articles or by-laws because it provides stronger protection for shareholders than a board policy which can be changed by the board without shareholder approval.[33] However, this approach may not be subject to regulatory oversight (unless, of course, requirements with respect to the articles and by-laws were incorporated into regulation or legislation).

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31 Nortel's articles where adopted when BCE Inc. spun Nortel out in 2000. The "two-thirds" votes standard for director elections was effected for Canadian income tax purposes, as disclosed in the information circular describing the arrangement involving BCE Inc. and Nortel.

32 Nexen Inc., *Management Information Circular* (9 March 2007) at 16.

33 CCGG Policy: Majority Voting, March 2001, online: http://www.ccgg.ca/site/ccgg/assets/pdf/2011_MV_Policy.pdf

15.3 Allow shareholders to opt out

The CBCA could be amended provide the ability to opt out of the statutory default if the company proposed a resolution to this effect that was approved by shareholders representing a majority of the outstanding shares. Such resolutions, in their most basic form, would merely opt out of the binding majority voting default rule for director elections of distributing corporations. However, such resolutions could also be accompanied by proposals to adopt by-law amendments that would provide alternative procedures for directors who have failed to receive majority support – such as providing for a reasonable period to reconstitute the board. For example, shareholders may support opting out where the company has proposed a robust alternative in their by-laws and has earned the confidence of its shareholders through regular engagement and dialogue.

Shareholders should, however, also be permitted to initiate such a vote. The process for opting out by shareholders from a binding majority voting standard would also leave the door open for shareholders to later reverse their choice and opt back into the default rule. Public companies evolve and shareholders' preferences may shift over time, with new information and as the shareholder base changes. Through the existing shareholder proposal mechanism of the CBCA, companies that are not subject to the binding majority voting default standard would again become subject to the default standard once shareholders representing a majority of the outstanding shares approve a resolution to that effect. Public companies would therefore not be subject to the binding majority voting default standard only if an opt out resolution was passed by shareholders representing a majority of the outstanding shares, and no subsequent shareholder proposal resolution to opt back into the default standard has been passed by shareholders representing a majority of outstanding shares. Another alternative would be to provide a sunset provision for any resolution to opt out of the CBCA binding majority voting default standard.

15.4 Irrevocable director resignations

The CBCA could be amended to make clear that a director resignation that is contingent on the occurrence of a future event is effective. Directors could then provide to the board, resignations that are effective at a time (90 days or 120 days, for example) after the date on which that director is voted down by shareholders. This would give the board a date certain by which it would lose the director (but some time to recruit a replacement if needed).

15.5 Allow the board the flexibility to raise "exceptional circumstances"

The CBCA could allow directors to keep on the board, a director who has been voted down by shareholders in "exceptional circumstances". This would better align director elections in CBCA public companies with those in TSX listed companies governed by the corporate statutes of other jurisdictions. Rather than the TSX overseeing the application of this standard, as is the case now, shareholders could sue companies if they believed that this standard was being applied inappropriately. Alternatively, the CBCA could allow the company to apply to

the court for an order appointing the director to the board, despite being voted down, under "exceptional circumstances". A body of case law could develop which would inform the actions of boards in the future. Of course, proponents of binding majority voting would likely find this to be an unacceptable approach and not much different from the status quo.

16. Other ways to improve the director election process

16.1 Use the form of proxy to enhance communications by shareholders

Shareholders will no longer be shooting with blanks when the "withhold" vote becomes an "against" vote. As noted above, there is no reason to think that this will result in widespread ejection of directors from their board seats. However, there is a risk that shareholders may be reluctant to vote against a director because what they want to do is to send a message, not lose the director from the board.

If shareholders worry about matters going too far by voting against directors, will they be reluctant to do so? If that is the case, they may vote in favour of a director although they are not entirely convinced (or would have liked to send some kind of message). They may also decide not to cast a vote with respect to that director.

If shareholders vote against a particular candidate for election, will that candidate (or the board) understand why they did so? Shareholders often say that public companies and their boards should understand the views of shareholders so that they are never surprised by the results of a vote. In many situations, that is a valid observation. For example, if a candidate sits on eight other public company boards, the board should not be surprised if shareholders vote against that candidate. In other situations, it is more difficult for the board to anticipate the outcome of an election. For example, shareholders may target the chair of the compensation committee to communicate their dissatisfaction about executive compensation. In many of these cases, boards engage with shareholders before and after the meeting to understand their discontent – such as whether they are related to the board's executive compensation policies or the company's recent financial performance. However, boards may have difficulty in identifying their shareholders, given the particularities of the OBO/NOBO system, to meaningfully engage with them.

Both of these issues could be addressed by allowing for more nuanced messaging. One approach is to provide shareholders with a third box. Where this is used in other jurisdictions (in the United Kingdom, for example and by some U.S. companies), the box is labelled "abstain". The question would then be how the abstain votes should be tabulated in determining whether the requisite majority of votes cast has approved a director candidate. For example, when calculating the "for" percentage for TSX listed companies, the total of "for" votes is used as the numerator, and the sum of the for and against vote is used as the denominator. Any other votes, including no-votes from U.S. intermediaries and spoiled votes, are not included in the calculation. (As a result, the denominator used in each calculation is

different from the total votes cast at the meeting and different for each director.) A consistent standard would need to be implemented to confirm that "abstain" votes are not included in the denominator. The ballot used for in-person voting at the shareholders' meeting would also need to be considered, along with the instructions provided to shareholders explaining the consequences of each voting option.

"Abstain" does not deliver any type of message (anymore than a withhold vote does). It is, of course possible to be more creative. Shareholders could have the option of voting "for", "against" or "serious reservations", for example. There are of course drawbacks to making the form of proxy too complicated. The point is that there is no reason that the proxy cannot provide opportunities for shareholders to communicate more nuanced views about the candidates for election. Leaving shareholders with "for" and "against" as their only options creates too blunt an instrument.

We understand that the systems used by Broadridge and others in the proxy voting system can accommodate this additional complication to the form of proxy.

16.2 Enhancing the approach to shareholder democracy in the context of director elections

Majority voting is only one of the mechanisms available to facilitate greater shareholder participation in the election of directors and advance shareholder democracy. Majority voting should not be considered in isolation and other reforms that merit further discussion would include proxy access, for example. Proxy access refers to the right of shareholders to nominate one or more candidates to be included in the company's management proxy circular and form of proxy. While the CBCA already allows a shareholder or group of shareholders holding 5% of the company's outstanding shares and meeting certain other requirements to nominate a director in the management proxy materials by submitting a shareholder proposal, the issue of extended proxy access is gaining momentum in Canada. As of the date of this paper, two shareholder proposals were submitted to Canadian banks asking the board to adopt a by-law extending proxy access to a shareholder or group holding 3% or more of the bank's outstanding shares and meeting certain other requirements. The first shareholder proposal submitted to The Toronto-Dominion Bank passed with 52.2% shareholder support and the other proposal submitted to the Royal Bank of Canada was narrowly defeated with 46.8% of shareholders voting in favour. Similar to other shareholder initiated governance issues (such as majority voting and say-on-pay), the introduction of proxy access in Canada follows the adoption in the U.S. (through shareholder proposals or voluntarily) providing for proxy access in the company's by-laws.[34]

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[34] As of December 31, 2016, 342 companies in the U.S. had adopted a proxy access by-law (including more than half of the companies included in the S&P 500 Index). While the details of the proxy access by-laws

While a complete discussion of proxy access is beyond the scope of this paper, we have set out below additional reforms for securities regulators to consider in enhancing the director election process.

16.2.1 Disclosure about the nomination process

The director election process could benefit from more meaningful disclosure about the board's process to nominate directors and whether the board regularly engages with its major shareholders about the board's renewal process. The appropriate means to implement this option would be through the securities regulators' current corporate governance disclosure requirements.[35] Non-venture issuers are already required to describe the process by which the board identifies new candidates for board nomination.[36] However, a disclosure review completed by CSA staff in 2010 identified "significant disclosure deficiencies" in this area and found that many companies did not meaningfully describe the process by which the board identifies new candidates for board nomination.[37] The same review also found that a significant portion of companies reviewed did not satisfy the disclosure requirements related to the board's assessment of its effectiveness. The securities regulators may consider proposing additional requirements or publishing a staff notice that sets out staff's expectations regarding the disclosure provided about the board's process to evaluate its performance and identify new candidates for board nomination.

16.2.2 Disclosure about directors appointed by the board

When directors are put forward to shareholders for election, shareholders receive extensive information about the candidate. This information is required to be set out in a proxy circular sent to shareholders in advance of the meeting. The purpose of this disclosure is to provide sufficient information on the matters to be voted upon at the meeting to enable the shareholders to make a reasoned judgment on the matter.

In addition to the name of the candidate, the proxy circular must disclose the candidate's place of residence, principal occupation and employment history during the past five years. It

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adopted in the U.S. vary across companies, most by-laws provide that shareholders holding 3% of the company's outstanding shares for three years may nominate and include in the company's proxy materials candidates for up to 20 percent of the board and form a group of up to 20 shareholders to meet the 3% ownership requirement.

35 National Instrument 58-101 *Disclosure of Corporate Governance Practices*, which incorporates Form 58-101F1 *Corporate Governance Disclosure* [Form 51-101F1].

36 Form 58-101F1, s 6(a).

37 CSA Staff Notice 58-306 *2010 Corporate Governance Disclosure Compliance Review* (3 December 2010), online: <http://www.osc.gov.on.ca/documents/en/Securities-Category5/csa_20101203_58-306_2010-corp-gov-disclosure.pdf>.

must also disclose other public company boards on which the director serves. This disclosure provides the basis for shareholders to determine whether the director is "overboarded" in their view. The proxy circular also discloses details of any cease trade orders,[38] bankruptcies,[39] penalties or sanctions[40] relating to the candidate.

Details of the candidate's interest in the public company must also be disclosed. This includes the number of securities of each class of voting securities of the company or any of its subsidiaries the candidate holds directly or indirectly, as well as any indebtedness of the candidate to the company or any of its subsidiaries. In addition, if the candidate has any direct or indirect material interest in any matter that is the subject of a vote at the meeting or any transaction that is material to the company, the details of this material interest must be disclosed.

Shareholders should have this information about anyone who sits on the board. This is true whether or not the director is proposed as a candidate at the meeting or appointed by the board between annual meetings. Accordingly, we recommend that the securities regulators require this disclosure for directors who have been appointed to the board between annual meetings.

17. Other problems with the director election provisions of the CBCA that should be addressed

In the course of preparing this paper, we encountered a number of points of ambiguity in the CBCA provisions relating to director elections and some possible inconsistencies between the language of the statute and the way it is interpreted in practice. We raise two of these issues for the reader's consideration.

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[38] A cease trade order is a decision issued by a securities regulator against a company or an individual for reasons such as failing to meet disclosure requirements or as a result of a securities enforcement action. A director who is, or has been within the last 10 years, the subject of a cease trade order that was issued or resulted from an event that occurred while the director was acting in the capacity of a director, CEO or chief financial officer of the company must disclose this fact and describe the basis on which the order was made and whether the order is still in effect.

[39] If the director is or was a director or executive officer of a company during the past 10 years that became bankrupt or made a proposal under legislation for bankruptcy or insolvency during the director's tenure or within a year of leaving the company, this fact must be disclosed. Similar facts relating to any personal bankruptcy must also be disclosed.

[40] The company must also describe any penalties or sanctions imposed by a court relating to securities legislation or by a securities regulatory authority, including the circumstances that gave rise to any settlement agreement entered into by the director, or other penalties or sanctions imposed by a court or a regulatory body that would likely be considered important to a reasonable shareholder in deciding whether to vote for a proposed director.

17.1 Fixing the number of directors

As noted above, almost all CBCA companies listed on the TSX have floating boards. However, the CBCA does not set out how the number of directors within the range set out in the articles is to be determined. Although it makes sense that shareholders should make that determination, the CBCA does not provide shareholders with the authority to do so. If shareholders implicitly make that determination based on the number of directors they elect at the annual meeting, then it would seem that shareholders could elect the nominees put forward by the incumbent board, as well as any other nominees put forward, up to the maximum permitted in the articles. On the other hand, since residual authority falls to the board under the CBCA, perhaps it is the directors who determine the number within the range when they determine how many candidates to nominate. Or perhaps the shareholders can give the directors the right to set the number of directors through the by-laws.

This issue has been a source of debate and confusion for many years. The legislature considered this issue when it added a provision at section 106(8) of the CBCA allowing directors to appoint one or more additional directors between shareholder meetings (provided that the total number of directors so appointed did not exceed one third of the number of directors elected at the previous annual meeting of shareholders). Consultations during the legislative process revealed that lawyers had been interpreting the CBCA in very different ways. The Barreau du Québec recommended against allowing directors to appoint additional directors, noting that it was a fundamental principle of shareholder democracy that shareholders elect directors. However, other groups believed it was already the case that, where the articles provided for a variable number of directors, the shareholders could be taken to have authorized an increase within the range. Other lawyers adopted a narrower interpretation which, as discussed in section 5.5.3 below, is consistent with the legislative intent behind subsection 111(1).[41]

The OBCA does set out a process for setting the number of directors within a range and how the directors can appoint additional directors within this range:

> 124(2) Where a special resolution passed under subsection 125(3) empowers the directors of a corporation the articles of which provide for a minimum and maximum number of directors to determine the number of directors, the directors may not, between meetings of shareholders, appoint an additional director if, after such appointment, the total number of directors would be greater than one and one-third times the number of directors required to have been elected at the last annual meeting of shareholders.
>
> ....
>
> 125 (3) Where a minimum and maximum number of directors of a corporation is provided for in its articles, the number of directors of the corporation and the number of directors to be elected at the

[41] Technical Amendments Discussion Paper, *supra* note 33 at paras 184-193.

> annual meeting of the shareholders shall be such number as shall be determined from time to time by special resolution or, if the special resolution empowers the directors to determine the number, by resolution of the directors.

The Canadian Bar Association – National Business Law Section recommended against adopting the Ontario rules because of their complexity. Instead, it recommended modelling subsection 106(8) of the CBCA on the British Columbia *Company Act*,[42] which was simpler. The legislature followed this recommendation. However, the British Columbia *Company Act* did not provide for a minimum and maximum number of directors, which is why there was no need to address the issue of fixing the number of directors.[43]

More recently, the *Canada Not-for-profit Corporations Act*[44] addressed the issue by including a provision similar to subsection 106(8) of the CBCA, but also setting out a process for fixing the number of directors:

> 128(8) The directors may, if the articles of the corporation so provide, appoint one or more additional directors, who shall hold office for a term expiring not later than the close of the next annual meeting of members, but the total number of directors so appointed may not exceed one third of the number of directors elected at the previous annual meeting of members.
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> ....
>
> 133 (3) If a minimum and maximum number of directors is provided for in the articles, the members may, from time to time by ordinary resolution, fix the number of directors of the corporation and the number of directors to be elected at annual meetings of the members or delegate those powers to the directors. No decrease in the number of directors shall shorten the term of an incumbent director.

It would be helpful to include a provision in the CBCA similar to section 133(3) of the *Canada Not-for-profit Corporations Act*.

17.2 Clarifying the discretion of the proxyholder

The form of proxy has been regulated since the 1960s, originally to curtail management practices that were designed to influence shareholders to vote in favour of management's proposals. The law has long provided that shareholders may not give the proxyholder discretion with respect to the election of directors. The shareholder may only instruct the proxyholder to vote in favour of a candidate or withhold instructions from the proxyholder. The provision currently applicable to CBCA companies reads in part as follows:

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42 *Company Act*, SBC 2002, c57.

43 Technical Amendments Discussion Paper, *supra* note 33 at para 192.

44 *Canada Not-for-profit Corporations Act*, SC 2009 c 23.

> 9.4 (4) A form of proxy sent to securityholders of a reporting issuer must provide an option for the securityholder to specify that the securities registered in the securityholder's name will be voted for or against each matter or group of related matters identified in the form of proxy, in the notice of meeting or in an information circular, ***other than the appointment of an auditor and the election of directors***. [Emphasis added]
>
> (5) A form of proxy sent to securityholders of a reporting issuer may confer discretionary authority with respect ***to each matter referred to in subsection (4)*** as to which a choice is not specified if the form of proxy or the information circular states in bold-face type how the securities represented by the proxy will be voted ***in respect of each matter or group of related matters.*** [Emphasis added]
>
> (6) A form of proxy sent to securityholders of a reporting issuer must provide an option for the securityholder to specify that the securities registered in the name of the securityholder must be voted or withheld from voting in respect of the appointment of an auditor or the election of directors.

Notwithstanding these provisions, proxies are often issued that purport to give the proxyholder the right to cast the shareholder's vote for the director candidate, even though the shareholder has given the proxyholder no authority to do so. For example:

> If you do not specify how you want your shares voted, the directors named as proxyholders in the proxy form or voting instruction form intend to cast the votes represented by proxy at the meeting FOR the election as directors of the nominated directors in this circular.

It seems to us that proxyholders are not entitled to cast a shareholder's vote in respect of a director election unless specifically instructed to do so by the shareholder.

18. Rethinking the intersection of corporate and securities law

Majority voting presents an opportunity to rethink the way that corporate and securities law in Canada intersect more generally on issues such as director elections and to consider whether changes should be made.

The CBCA sets out the legal and regulatory framework for all companies incorporated under this statute, including large, small and medium-sized businesses, as well as private companies and companies that issue publicly-traded securities. For public companies, the director election requirements are governed under both the CBCA and provincial securities legislation. Director elections are a matter of corporate law. Securities legislation sets out the prescribed disclosure requirements for proxy circulars and content requirements for the form of proxy, including providing the option for the shareholder to vote "for" or "withhold" in respect of the election of directors. The CBCA regulations adopt the form of proxy requirements under securities law. Since majority voting is distinctively relevant only to public companies and provincial securities legislation already prescribes requirements for the election of directors, wouldn't this matter be better dealt with by the securities regulators?

It is worth discussing whether the federal government should step back from the process for electing public company directors and leave the matter to be regulated by provincial securities legislation. Provincial securities legislation already regulates the corporate governance of public companies and the disclosure provided to shareholders in advance of shareholder meetings. Provincial securities legislation also prescribes obligations in respect of the delivery of meeting information and materials to beneficial shareholders (beyond the requirements imposed under corporate law). Providing rulemaking authority to the securities regulators to prescribe requirements in respect of the election of directors of public companies (beyond the requirements imposed under corporate law) would be consistent with provincial securities regulators' jurisdiction in respect of proxies and proxy circulars filed for shareholder meetings of public companies.

The CBCA should also seek to avoid any duplication with corporate governance requirements currently applicable to public companies. Previous amendments to the CBCA have followed this approach to harmonize the CBCA with provincial securities legislation and avoid duplication. For example, the 2001 amendments to the CBCA repealed provisions related to insider trading and take-over bids as these topics were already extensively covered by provincial securities legislation. Further harmonization of public company requirements under the jurisdiction of the securities regulators should be encouraged to ensure that investors receive the same corporate governance rights and public companies are held to the same standards regardless of their jurisdiction of incorporation.

One further advantage of leaving public company matters to the securities regulators is that it will avoid a checkerboard approach to director elections in Canada.

The CBCA Amendments would impose multiple regulatory frameworks in respect of director elections for CBCA incorporated companies. TSX listed companies governed by the CBCA will be subject to a binding majority voting standard for director elections, while the other TSX listed companies will continue to follow the TSX majority voting requirement, which provides boards some flexibility to reject a resignation in "extraordinary circumstances". More limiting, TSXV listed companies that are governed by the CBCA would be subject to a binding majority voting standard, while all other TSXV companies would not be subject to any majority voting requirement (including the requirement to adopt a director resignation policy in respect of director elections).

19. What we can learn from other jurisdictions

As we wrestle with the majority voting issue in the Canadian marketplace, the question of how other jurisdictions deal with this issue often arises.

The U.S. experience is particularly relevant, since the CBCA (and most other Canadian corporate statutes) are similar to U.S. state law in respect of director elections. Most U.S. states

now allow companies to provide for majority voting in their by-laws (generally along the same lines as the TSX majority voting requirement).

19.1 United States

The approach used in Delaware and under the Model Business Corporations Act (which many of the other state corporate statutes follow) are discussed below. A more complete discussion of the history of the move to majority voting in the U.S. is discussed in Schedule D. The text of the majority voting provisions in the Delaware statute and the Model Business Corporations Act is set out in Schedule E to this Discussion Paper. We also discuss briefly the majority voting approach in the United Kingdom and Australia.

19.1.1 Delaware

Under the Delaware statute, directors are elected by a plurality of the votes of the shares present in person or represented by proxy, unless the company's certificate of incorporation or by-laws provide otherwise. The amendments to the Delaware statute in respect of director elections, which came into force on August 1, 2006, are consistent with Delaware's historical approach of giving corporations flexibility in their governance arrangements through private ordering. Specifically, the provisions in section 141(b) related to director elections were amended to allow director resignations to be made effective upon the happening of a future event or events (such as a failure to receive a specified vote for election), and to provide that such resignations may be made irrevocable. Moreover, the majority voting amendments added a new sentence to section 216 to provide that "a by-law amendment adopted by the stockholders which specifies the votes that shall be necessary for the election of directors may not be repealed or amended by the board of directors." The purpose of this amendment was to protect shareholders with respect to the election of directors by removing the authority of the board of directors to amend a by-law the company's shareholders have previously adopted. When coupled with board acceptance of a director resignation, these provisions permit companies and individual directors to agree voluntarily to voting standards for the election of directors that differ from the plurality default standard.

If a director resigns following the failure to achieve a majority vote, section 223 of the Delaware statute governs how vacancies are filled. Unless the certificate or by-laws provide otherwise, vacancies may be filled by a majority of the directors elected remaining in office, or by the sole remaining director elected. Also, unless the company's certificate or by-laws provide otherwise, a director who resigns effective at a future date may participate in the selection of his or her successor.

19.1.2 Model Business Corporations Act

The Corporate Laws Committee,[45] which is responsible for the Model Act, adopted the same approach as Delaware, leaving the plurality voting standard in the Model Act unchanged. It too allows individual corporations to adopt majority voting through private ordering.[46]

The Model Act majority voting amendments were adopted on June 20, 2006. First, the majority voting amendments modified the director resignation provisions of the Model Act to explicitly permit director resignations conditioned upon the occurrence of a specific future event (such as upon failing to receive a specified vote for election as a director) and to permit that a director resignation can be irrevocable.[47] These amendments to the director resignation provisions of the Model Act are similar to section 141(b) of the Delaware statute discussed above. Moreover, the Model Act allows a company to adopt a by-law providing for majority voting for the election of directors and confirm the procedures by which corporations may repeal the by-law provisions relating to the election of directors. Specifically, if the by-law provision was originally adopted by shareholders, only the shareholders can repeal the by-law, unless the by-law provides otherwise.[48]

However, unlike the Delaware statute, the provision related to by-law amendments in the Model Act goes further and provides that a director nominee who fails to receive a majority of "for" votes will only serve as a director for a term ending on the earlier of 90 days following the election or the date the board of directors selects a different individual to fill the board seat.[49]

19.2 United Kingdom and Australia

The observation is often made that we should look to other jurisdictions, including the United Kingdom and Australia, which already provide for a majority voting standard for the election of directors. We raise two cautions in response. First of all, importing selected provisions from statutes of other jurisdictions into Canadian law is more complicated than it may appear. For example, an important number of public companies in Australia have staggered boards, where a limited number of directors (usually one third of the board) are elected annually. As explained in this Discussion Paper, staggered boards are not an important feature in the

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[45] The Corporate Laws Committee of the Business Law Section of the American Bar Association is responsible for adopting amendments to and providing expert commentary on the Model Business Corporation Act. Carol Hansell serves as Special Canadian Advisor to the Corporate Laws Committee.

[46] American Bar Association, Committee on Corporate Laws of the ABA Section of Business Law, *Report on the Roles of Boards of Directors and Shareholders of Publicly Owned Corporations* (2010), online: <http://www.abanet.org/media/nosearch/task_force_report.pdf>.

[47] Model Act, s. 8.07.

[48] Model Act, s. 10.22.

[49] Model Act, s. 10.22.

governance of the Canadian public companies and have been specifically prohibited for companies that are listed on the TSX. The use of staggered boards for public companies in Australia helps to avoid "failed elections", for example. The Australian corporate statute also allows a board that does not have a quorum in place to appoint additional directors in order to make up the quorum.[50]

Secondly, other jurisdictions allow public companies to communicate differently with their shareholders than is permitted in Canada and the United States. For example, beneficial shareholders in the U.S. and Canada may elect to be Non-Objecting Beneficial Owners (NOBO) or Objecting Beneficial Owners (OBO). The identity of OBOs is not disclosed and public companies cannot communicate directly with them. These features are unique to the North American markets and add layer of complexity for public companies in seeking identify and engage with their shareholders. Other jurisdictions, such as the United Kingdom, have a longer history of engagement between investors and public companies.

Institutional investors in the United Kingdom are also expected to report on how they fulfill their stewardship responsibilities on a "comply or explain" basis against recommended principles and guidance in the UK Stewardship Code.[51] One of the purposes of that stewardship code is to enhance the quality of engagement between investors and companies. On of the seven principles it sets out is that institutional investors should establish clear guidelines on when and how they will escalate their stewardship activities. That level of transparency does not exist between Canadian companies and many of their institutional investors.

20. A comment on the CBCA consultation process

When the proposed amendments to the CBCA discussed in this paper will ultimately become law remains a question, but there is certainly more than enough time in the process for the changes to director elections to be in force in time for the 2018 proxy season.

This section describes the consultation process in which the federal government engaged with respect to the proposed amendments, to the extent that those consultations are on the public record.

As a general observation, the comments received by the federal government that are available on the public record are overwhelmingly in support of majority voting. However, many of the commenters have expressed strong and well reasoned concerns about "binding" majority

[50] *Corporations Act 2001* (Cth) s 201H.

[51] The principles and guidance are set out in the UK Stewardship Code, which is overseen by the Financial Reporting Council.

voting being introduced through the CBCA. They have asked the federal government to pause and engage in broader consultation. We understand that the federal government has not accepted the comments received from those who have concerns with the proposed amendments or their suggestions for improvements to those amendments if they do proceed.

20.1 The legislative process

The Government of Canada introduced Bill C-25, *An Act to amend the Canada Business Corporations Act and other Acts*, for first reading in the House of Commons on September 28, 2016. The CBCA Amendments form part of that bill, along with other amendments to the CBCA relating to board diversity, among others. The Bill went through second reading on December 9, 2016 and was referred to the Standing Committee on Industry, Science and Technology (the "Committee").

The Committee considered the Bill at nine meetings,[52] received ten written briefs from stakeholders[53] and has heard submissions through 14 witness presentations.[54] The Committee

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52 House of Commons, Standing Committee on Industry, Science and Technology (the "Committee"); Meetings considering "Bill C-25, *An Act to amend the Canada Business Corporations Act, the Canada Cooperatives Act, the Canada Not-for-profit Corporations Act, and the Competition Act*", held on February 2, 7, 9, 14, 16 and 21 February and 7, 9 and 21 March 2017; online: <http://www.parl.gc.ca/Committees/en/INDU/StudyActivity?studyActivityId=9312369>.

53 Briefs filed with the Committee by: Chambre des notaires du Québec; Diversity Institute at Ryerson University; Canadian Coalition for Good Governance; Securities Transfer Association of Canada; Canadian Investor Relations Institute; Canadian Bar Association; Co-operatives and Mutuals Canada; Publish What You Pay Canada; Barreau du Québec; and Transparency International Canada; online: <http://www.parl.gc.ca/Committees/en/INDU/StudyActivity?studyActivityId=9312369>.

54 The witnesses making the 14 presentations before the Committee were: Mark Schaan, Director General, Marketplace Framework Policy Branch, Strategic Policy Sector, Department of Industry; Colleen Kirby, Manager, Policy Section, Corporations Canada, and Mark Schaan, Director General, Marketplace Framework Policy Branch, Strategic Policy Sector, Department of Industry; Clare Beckton, Executive Director, Centre for Women in Politics and Public Leadership; Claire Woodside, Director, and Mora Johnson, Barrister and solicitor, Publish What You Pay Canada; Catherine McCall, Director of Policy Development, and Stephen Erlichman, Executive Director, Canadian Coalition for Good Governance; Tanya van Biesen, Executive Director, Catalyst Canada Inc.; Matthew Fortier, Vice President, Policy, Institute of Corporate Directors; Aaron Dhir, Associate Professor, Osgoode Hall Law School of York University; John Knubley, Deputy Minister, and Mark Schaan, Director General, Marketplace Framework Policy Branch, Strategic Policy Sector Department of Industry; Hon. Navdeep Bains, Minister of Innovation, Science and Economic Development, House of Commons; Wendy Cukier, Director, Diversity Institute at Ryerson University; Paul Schneider, Head of Corporate Governance, Public Equities, Ontario Teachers' Pension Plan Board; Denis Meunier, Member, Beneficial Ownership Working Group, and Paul Lalonde, President and Chair of the Board of Directors, Transparency International Canada; Mark Schaan, Director General, Marketplace Framework Policy Branch, Strategic Policy Sector, and Mitch Davies, Assistant Deputy Minister, Strategic Policy Sector, Department of Industry; online: <http://www.parl.gc.ca/Committees/en/INDU/StudyActivity?studyActivityId=9312369>.

concluded its review and adopted the Bill with minor amendments on March 21, 2017.[55] The Committee presented its report on the Bill to the House of Commons on March 22, 2017.

Bill C-25 is now in the House of Commons awaiting calling for third reading.[56] Assuming the Government adopts Bill C-25, it will then be sent to the Senate, where it will follow a similar process. The Senate process can take another six months or more. Assuming successful passage in the Senate, the Bill will come into force on dates to be fixed by the Governor in Council once it receives Royal Assent. Accordingly, subject to any measures to affect passage of Bill C-25, it may come into force in time for the 2018 proxy season.

20.2 The consultation process was not commensurate with the significance of the changes to director elections

Although majority voting engages issues that are fundamental to shareholder democracy, the process that has led to the CBCA Amendments was far from transparent. There was far less consultation than there has been in the past for amendments to the CBCA (as discussed in detail in Schedule F). Consultation before the current amendments were drafted was limited to a single discussion paper, in contrast with previous amendments in 2001, which resulted from a series of discussion papers and consultations.

Comments provided to the government on Bill C-25 outside of the Committee process are not on the public record. Moreover, when the government did call for comments on the amendments themselves, it would have been difficult for many interested stakeholders to know that the opportunity to comment even existed. That opportunity was communicated through a news release dated February 8, 2017 which was issued and distributed through the normal process for committee news releases. In other words, it was posted to the website of the Committee and was distributed to the Parliamentary press gallery (i.e., the journalists who cover parliamentary activities). The government did not, for example, alert parties who had provided submissions earlier in the process and so many stakeholders missed the opportunity to provide comments on the steps being proposed by the government. Interested parties had only until February 21, 2017 to submit their briefs.

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[55] The amendments are largely of a housekeeping nature, with a substantive amendment requiring a review of the new diversity provisions within five years of them coming into force: online: <http://www.parl.gc.ca/HousePublications/Publication.aspx?Language=e&Mode=1&Parl=42&Ses=1&DocId=8802825>.

[56] <http://www.parl.gc.ca/LegisInfo/BillDetails.aspx?Language=E&Mode=1&billId=8433563>.

20.3 Lack of balance of the views of stakeholders

When Industry Canada undertook a public consultation in 2014 on potential amendments to the CBCA,[57] there was a clear divide between the investor community and the issuer community.[58] Supporters of majority voting – generally shareholder groups and those who work with them – argued that shareholders should be able to elect and hold individual directors accountable by voting against them.[59] However, while some commenters supported a binding majority voting standard for director elections,[60] many of the comment letters did not specifically address the distinction between binding majority voting and the director resignation approach adopted by the TSX (acknowledging that the TSX majority voting requirement was to come into force on June 20, 2014). A number of supporters noted that the CBCA should legislate majority voting in a manner that is consistent with the TSX majority voting requirement.[61] For example, the comment letter from the Ontario Teachers' Pension Plan supported legislating the key elements of majority voting for CBCA companies, "requiring directors who fail to garner majority support to resign and for boards to accept that resignation except in truly exceptional circumstances."[62] Commenters who were not in favour of legislating majority voting argued that the CBCA should not overlap with the corporate governance framework and duplicate securities law requirements applicable to public companies.[63] Specifically, they noted that securities law and the TSX listing requirements are flexible and recognize the governance considerations of controlled companies and smaller public companies. Commenters also requested that Industry Canada work with the provincial securities regulators and the TSX to promote a consistent legislative framework for shareholder rights and corporate governance.[64]

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57 *Consultation on the Canada Business Corporations Act* (Ottawa: Industry Canada, 2014) online: <https://www.ic.gc.ca/eic/site/cilp-pdci.nsf/eng/h_cl00867.html>.

58 Comments received on the *Consultation on the Canada Business Corporations Act*, online: <https://www.ic.gc.ca/eic/site/cilp-pdci.nsf/eng/h_cl00880.html>.

59 Letter from ICGN (15 May 2014).

60 Letter from Hermes Equity Ownership Services (14 May 2014); Letter from Shareholder Association for Research & Education (15 May 2014).

61 Letter from Alberta Investment Management Corporation (13 May 2104); Letter from OMERS Administration Corporation (12 May 2014); Letter from BlackRock (14 May 2014); Letter from British Columbia Investment Management Corporation (15 May 2014); Letter from NEI Investments (15 May 2014).

62 Letter from Ontario Teachers' Pension Plan (15 May 2014).

63 Letter from Bennett Jones LLP on behalf of Canadian Utilities Limited (14 May 2014); Letter from Institute of Corporate Directors (11 March 2014); Letter from IGM Financial (15 May 2014); Letter from Norton Rose Fulbright Canada LLP (13 May 2014); Letter from Power Corporation of Canada (12 May 2014); Letter from Stikeman Elliott LLP (9 May 2014); Letter from TMX Group Limited (15 May 2014).

64 Letter from the Canadian Securities Administrators (8 May 2014); Letter from NEI Investments (15 May 2014); Letter from Talisman Energy Inc. (12 May 2014).

In its consideration of the Bill in the current process, the Committee recognized that the investor community and the issuer community do not agree on the approach to majority voting used in Bill C-25. The result of the Committee process shows that the Committee was unpersuaded by the views of the issuer community. We note two examples of input provided:

- A letter from Norton Rose Fulbright Canada LLP to the Chair of the Committee (reflecting the views of a working group comprised of companies having a combined market capitalization of more than $150 billion) raised concerns in respect of the CBCA Amendments.[65] The letter made recommendations to the Committee to improve the wording of the draft legislation and address concerns related to failed elections. From our review of the Committee's proceedings, we did not find this letter on the public record and the recommendations advanced by the working group did not result in any change in the legislation being proposed.

- The Institute of Corporate Directors raised a number of issues with the Committee (in part with reference to an early draft of this paper). Mr. Fortier testified on behalf of the ICD in part as follows.

> In a soon-to-be-released discussion paper, the law firm Hansell LLP—one of Canada's leading authorities on corporate governance matters—has flagged a number of potentially problematic consequences of the proposed amendments. These include uncertainty about the size of the board. That's to say that if a number of directors do not achieve a majority of “for” votes but the board still attains quorum, the board can continue to operate at a much reduced size, say from seven people down to three. Needless to say, a much smaller board may find it very hard to operate effectively. Another potential issue is the inability of shareholders to have a say on the replacement directors. Under the proposal, directors who remain in office can increase the size of the board by one-third. They can appoint whomever they want, and shareholders won't be able to approve or disapprove of them until the next AGM.
>
> A final challenge concerns the potential actions of dissident shareholders. It's plausible that a dissident shareholder with a significant percentage of voting shares may use this change in the legislation to target one or more directors in a self-interested campaign. Without the ability to reject a director's resignation in exceptional circumstances, as is now the case, the board may lose quality directors because they were unfairly targeted.[66]

We understand that the issues raised by the Institute of Corporate Directors did not result in any change in the legislation being proposed.

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[65] Letter from Norton Rose Fulbright Canada LLP to Dan Ruimy, Chair of the Standing Committee on Industry, Science and Technology (22 December 2016).

[66] House of Commons, Standing Committee on Industry, Science and Technology, 42nd Parliament, 1st Session (16 February 2017) at 845 (Matthew Fortier), online: <http://www.parl.gc.ca/HousePublications/Publication.aspx?Language=e&Mode=1&Parl=42&Ses=1&DocId=8775921#Int-9379915>.

Part V – Conclusions and Recommendations

The amendments to the CBCA currently being proposed with respect to majority voting would be unnecessarily disruptive to the business of public companies governed by the CBCA. If the federal government proceeds with those amendments, they should be revised to minimize that disruption. We have set out in this Discussion Paper, a number of ways this could be accomplished.

However, we suggest that the federal government reconsider whether any change to the CBCA to provide for majority voting is required (immediately, or at all). Companies representing 98.53% of the quoted market value of the Canadian capital markets are already subject to the majority voting requirements of the TSX. Those majority voting requirements are currently being road tested for a third time in the 2017 proxy season. Given that there were only a handful of directors who remained on the board after being voted down by shareholders in 2015 and none in 2016, it is premature to discard this regime for a new approach that will apply only to CBCA companies. We recommend that the federal government revisit the majority voting issue in five years. That should be sufficient time to judge whether the TSX majority voting regime has been successful in ensuring that TSX listed companies respect the majority vote in shareholder elections.

Changes in the way in which directors are elected under the CBCA will have immediate and meaningful consequences for a large percentage of public companies in Canada. In the absence of any existing governance crisis, it is more important that any amendments be implemented thoughtfully than that they be implemented quickly. The consultation process that led to Bill C-25 was not extensive or transparent enough to give stakeholders an opportunity to comment. The views of certain key stakeholders who did provide input (including representatives of issuers and of corporate directors) seem to have carried little weight. We recommend that a broader consultation process be held to consider how majority voting should best be handled in the Canadian marketplace. As part of that consultation process, the federal government should discuss with stakeholders whether public company governance issues such as majority voting should be addressed in corporate law or through securities regulation.

We have made a number of more specific recommendations throughout this Discussion Paper. We hope that some of them will form the basis of an approach to majority voting in Canada that meets the needs of a wider range of stakeholders.

Glossary of Terms

Terminology

A thorough examination of the statutory provisions is necessarily technical. We have endeavoured to limit the technical nature of this discussion in order to make it as readable as possible. We have sacrificed a level of detail and precision as a result.

We have also used terms that are user friendly, but not technically complete. For example, we refer to "shareholders" providing their proxies to the proxyholder, when in fact we are referring to a beneficial holder of shares providing a voting information form to an intermediary. We hope that this form of shorthand will connect the reader to the policy issues in the director election process, without unnecessary reference to the complicated procedures of the proxy voting system. For a detailed explanation of the proxy voting system, please see Carol Hansell et al, "The Quality of the Shareholder Vote in Canada" (22 October 2010), Davies Ward Phillips & Vineberg LLP, online: <https://www.dwpv.com/Sites/shareholdervoting/Additional-Resources.htm

Defined Terms

In this Discussion Paper, the following words and abbreviations have the meaning ascribed to them below.

ABA – means the American Bar Association.

Bill C-25 – means *An Act to amend the Canada Business Corporations Act and other Acts*, a bill introduced by the Government of Canada in September 2016.

Broadridge – means Broadridge Financial Solutions, Inc., a provider of investor communications and technology-driven solutions for wealth management, asset management and capital market firms.

CBCA – means the *Canada Business Corporations Act*, RSC 1985, c C-44.

CBCA regulations – means Canada Business Corporations Regulations, 2001, SOR/2001-512.

CCGG – means the Canadian Coalition for Good Governance, a not-for-profit corporation which represents the interests of institutional investors in the Canadian capital markets.

CSA – means the Canadian Securities Administrators, the umbrella organization of Canada's provincial and territorial securities regulators.

company – has the same meaning as in the TSX Company Manual (ie. the meaning ascribed to "company" in the *Securities Act* (Ontario) and also includes a trust, partnership or other form of business organization).

Delaware statute – means the Delaware General Corporate Law, the statute governing corporate law in the State of Delaware.

Floating board – means a board of directors where the articles of incorporation set a range for the number of directors the corporation must have, such as a minimum of 3 and a maximum of 15 directors.

ISS – means Institutional Shareholder Services Inc., a global provider of corporate governance research and other services for institutional investors.

Model Act – means the Model Business Corporations Act, a model general business corporation statute published by the Corporate Laws Committee of the Business Law Section of the American Bar Association.

OBCA – means the *Business Corporations Act*, RSO 1990, c B.16.

OSC – means the Ontario Securities Commission.

Russell 3000 Index – means the market capitalization weighted equity index maintained by FTSE Russell consisting of the 3000 largest publicly listed U.S. companies, representing about 98% of the total market capitalization of the U.S. equity markets.

SEC – means the United States Securities and Exchange Commission.

S&P 500 Index – means the Standard and Poor's 500 Index, a capitalization-weighted equity index of 500 U.S. companies with large market capitalization representing all major industries.

S&P/TSX 60 Index – means the capitalization-weighted equity index of 60 of the largest Canadian-incorporated companies listed on the Toronto Stock Exchange.

S&P/TSX Composite Index – means the headline equity index of the Toronto Stock Exchange and the principal broad market measure for the Canadian equity markets, which covers approximately 95% of the Canadian equities market.

Staggered board – means a board of directors where the terms of directors expire at different times, usually the terms of one-third of the directors expiring each year.

TSX – means the Toronto Stock Exchange.

TSX listed company – means a company whose equity securities are listed for trading on the Toronto Stock Exchange.

TSX majority voting requirement – means the majority voting requirement in sections 461.1 to 461.4 of the TSX Company Manual.

TSXV – means the TSX Venture Exchange.

TSXV listed company – means a company whose equity securities are listed for trading on the TSX Venture Exchange.

SCHEDULE A
Changes Being Proposed to Section 106 of the CBCA

The following is the text of the Section 106 of the CBCA, incorporating the amendments being proposed in Bill C-25 (highlighted to show those amendments).

Notice of directors

106 (1) At the time of sending articles of incorporation, the incorporators shall send to the Director a notice of directors in the form that the Director fixes, and the Director shall file the notice.

Term of office

(2) Each director named in the notice referred to in subsection (1) holds office from the issue of the certificate of incorporation until the first meeting of shareholders.

Election of directors

(3) Subject to subsection (3.1) and paragraph 107(b), shareholders of a corporation shall, by ordinary resolution at the first meeting of shareholders and at each succeeding annual meeting at which an election of directors is required, elect directors to hold office for a term ~~expiring~~ending not later than the close of the third annual meeting of shareholders following the election.

Election of directors — distributing corporations

(3.1) Subject to paragraph 107(b), shareholders of a distributing corporation shall, by ordinary resolution at the first meeting of shareholders and at each succeeding annual meeting at which an election of directors is required, elect directors to hold office for a term ending not later than the close of the next annual meeting of shareholders following the election.

Exceptions — certain distributing corporations

(3.2) Despite subsection (3.1), in the case of any prescribed class of distributing corporations or in any prescribed circumstances respecting distributing corporations or classes of distributing corporations, the directors are to be elected in accordance with subsection (3).

Separate vote for each candidate

(3.3) If the election of directors is for a prescribed corporation, a separate vote of shareholders shall be taken with respect to each candidate nominated for director.

Majority voting

(3.4) If, at a meeting of shareholders of a distributing corporation — other than in the case of a prescribed class of distributing corporations — at which an election of directors is required, there is only one candidate nominated for each position available on the board, each candidate is elected only if the number of votes cast in their favour represents a majority of the votes cast for and against them by the shareholders who are present in person or represented by proxy, unless the articles require a greater number of votes.

Staggered terms

(4) It is not necessary that all directors elected at a meeting of shareholders hold office for the same term.

No stated terms

(5) A director not elected for an expressly stated term ceases to hold office at the close of the first annual meeting of shareholders following the director's election.

Incumbent directors

(6) ~~Notwithstanding~~Despite subsections (2), (3) to (3.2) and (5), if directors are not elected at a meeting of shareholders, the incumbent directors continue in office until their successors are elected.

Vacancy ~~among candidates~~

(7) If, for either of the following reasons, a meeting of shareholders fails to elect the number or the minimum number of directors required by the articles~~ by reason of the lack of consent, disqualification, incapacity or death of any candidates~~, the directors elected at that meeting may exercise all the powers of the directors if the number of directors so elected constitutes a quorum~~.~~:

(a) a lack of consent, disqualification under subsection 105(1) or the death of any candidates; or

(b) a lack of a majority referred to in subsection (3.4).

Appointment of directors

(8) The directors may, ~~if~~unless the articles ~~of the corporation so~~otherwise provide, appoint one or more additional directors, who shall hold office for a term ~~expiring~~ending not later than the close of the next annual meeting of shareholders, but the total number of directors so appointed ~~may~~shall not exceed one third of the number of directors elected at the previous annual meeting of shareholders.

Exception

(8.1) If a candidate was not elected during an election held in accordance with subsection (3.4), the candidate is not to be appointed, except in prescribed circumstances, as a director under subsection (8) or 111(1) before the next meeting of shareholders at which an election of directors is required.

Election or appointment as director

(9) An individual who is elected or appointed to hold office as a director is not a director and is deemed not to have been elected or appointed to hold office as a director unless

(a) he or she was present at the meeting when the election or appointment took place and he or she did not refuse to hold office as a director; or

(b) he or she was not present at the meeting when the election or appointment took place and

(i) he or she consented to hold office as a director in writing before the election or appointment or within ten days after it, or

(ii) he or she has acted as a director pursuant to the election or appointment.

SCHEDULE B
Proposed Amendments to the CBCA Regulations

The following are the amendments to the CBCA Regulations that are relevant to Section 106, as it would be amended pursuant through Bill C-25.

[...]

4. *New* For the purpose of subsection 106(3.3) of the Act, a prescribed corporation is a distributing corporation.

5. *New* For the purpose of subsection 106(8.1) of the Act, the prescribed circumstances are that the individual who was not elected by subsection (3.2) is required to meet:

    (a) the requirement in subsection 102(2) of the Act for at least 2 directors who are not officers or employees of the corporation or its affiliates; or

    (b) the Canadian residency requirements in section 105 of the Act.

[...]

7. *Amendment* section 54(1) For the purpose of subsection 149(1) of the Act, **for a corporation that is holding a majority vote for directors as described in subsection 106(3.4) of the Act**, a form of proxy shall be in the form provided for in **paragraphs 1 to 5 and 7 to 9 of** section 9.4 (Content of Form of Proxy) of NI 51-102 **and shall also provide**:

    (a) **for voting on each director individually;**

    (b) **an option for the shareholder to specify that the shares registered in the name of the shareholder must be voted for or against in respect of the election of directors; and**

    (c) **an option for the shareholder to specify that the shares registered in the name of the shareholder must be voted for or withheld from voting in respect of the appointment of an auditor.**

Amendment section 54(2) For the purpose of subsection 149(1) of the Act, **for a corporation that is not holding a majority vote for directors as described in subsection 106(3.4) of the Act**, a form of proxy shall be in the form provided for in section 9.4 (Content of Form of Proxy) of NI 51-102 **and shall also provide for voting on each director individually**.

SCHEDULE C
Background to Majority Voting in Canada

This Schedule describes the history leading to the adoption of majority voting in Canada, from the first shareholder proposals filed to the approval of the TSX majority voting requirement.

1. The Push for Majority Voting in Canada

(a) Shareholder proposals

The first shareholder proposals in respect of majority voting in Canada were introduced in 2005. Shareholder advocate Robert Verdun issued identical proposals at seven financial institutions calling for super-majority voting for director elections (i.e., requiring directors to receive the support of at least 75% of the voting shareholders to be elected). To comply with the *Bank Act*,[67] the shareholder proposal specified that if fewer than seven directors received 75 % support, the required minimum of seven directors would be determined by those who received the most votes. The shareholder's explanation in support of the proposal made reference to the election of Gerald Schwartz to the board of The Bank of Nova Scotia who received support from 61.3% of voting shareholders at the company's 2004 annual shareholder meeting. These proposals received very little support – between 2 to 3.40% of shareholders voted "for".

In addition, the Carpenters Local 27 Pension Trust filed a shareholder proposal to Potash Corporation of Saskatchewan asking the company to adopt a majority voting policy, which was later withdrawn. Each of the eight companies that received shareholder proposals in 2005 adopted a majority voting policy that was disclosed in the management proxy circular filed for their 2006 annual meetings. We believe the urgency of adopting a majority voting policy, particularly by each of the large financial institutions, was closely related to the prominence of majority voting in the U.S. and the voluntary adoption of majority voting by large U.S. companies at the same time.

Although only one shareholder proposal calling for the adoption of majority voting has successfully passed during the period from 2005 to 2016 (the successful proposal was at European Goldfields Ltd. in 2011 – the company was acquired before its next annual meeting), they have tended to receive higher support than most other shareholder proposals. Excluding the supermajority voting policy proposals (which were not favorably received), the twelve shareholders proposals which have gone to the ballot received median support of 13%. Of these twelve shareholder proposals, eight proposals called for the adoption of a majority

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[67] *Bank Act*, SC 1991, c46.

voting policy for companies that had not adopted such a policy,[68] three proposals submitted to three financial institutions that had already adopted a majority voting policy called for the adoption of binding majority voting requiring that the director's resignation be accepted without any exception[69] and one shareholder proposal at Nexen Inc. in 2008 called for the adoption of a majority voting policy in addition to the existing by-law amendment that was previously adopted by the company.

(b) Majority voting policy developed by the CCGG

The CCGG was formed in 2002 (and incorporated in 2003) to promote good governance practices in the Canadian public companies owned by its members, who are primarily Canadian institutional investors, including pension funds, mutual funds and third party managers. Majority voting has been one of the most important priorities of the CCGG since at least 2004, based on comment letters sent to legislators and regulators.[70] Recognizing that changes to corporate law are not instantaneous, CCGG also advanced this issue by asking companies to adopt a majority voting policy as a "workaround" to the director election provisions under corporate law during its board engagement meetings with independent directors and also in letters written to board chairs.

CCGG adopted a model majority voting policy in August 2006 for uncontested shareholder meetings, which was updated in March 2011 (the "CCGG Model Policy").[71] The main difference between the 2006 version and the 2011 version relates to the inclusion of the "extraordinary circumstances" rationale to justify rejecting a resignation from a director who failed to receive a majority of votes cast. The 2006 version was less robust and only made reference to the expectation that a resignation would be accepted by the board within 90 days of the meeting.

Under the updated CCGG Model Policy released in 2011:

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68 The eight companies and year(s) the shareholder proposal was received include Cameco Corporation (2008); Power Financial Corporation (2008); European Goldfields Limited (2011); Quebecor Inc. (2012 and 2013); Alimentation Couche-Tard Inc. (2012 and 2013); Jean Coutu Group (PJC) Inc.

69 The financial institutions were Canadian Imperial Bank of Commerce; Bank of Montreal; and The Toronto-Dominion Bank.

70 See, e.g., CCGG Letter to OSC re MI 58-101 (May 25, 2004), online: <http://www.ccgg.ca/site/ccgg/assets/pdf/OSC_Guidelines_Response_May_25_2004.pdf>; CCGG Letter to Industry Canada re Proposals for Amendments to the CBCA (December 10, 2004), online: <http://www.ccgg.ca/site/ccgg/assets/pdf/CBCA_Amendments_from_CCGG.pdf>; CCGG Letter to CSA re NI 58-101 (December 13, 2004), online: <http://www.ccgg.ca/site/ccgg/assets/pdf/CCGG_Submission_NI_58-101_and_NP_58-201_Dec_2004.pdf>; CCGG Letter re Ontario Government Business Law Modernization Consultation (June 7, 2006), online: <http://www.ccgg.ca/site/ccgg/assets/pdf/Final_OBCA_Letter__CCGG_.pdf>.

71 Canadian Coalition for Good Governance, *Majority Voting Policy* (March 2011), online: <http://www.ccgg.ca/site/ccgg/assets/pdf/2011_MV_Policy.pdf>.

- the company will list each individual director nominee separately on the Form of Proxy or the Voting Instruction Form to allow shareholders to vote for each director individually;
- the company will promptly disclose the number of shares voted in favour or withheld from voting for each director after the meeting;
- a director who received more votes withheld than votes in favour will be expected to forthwith submit his or her resignation to the board, effective on acceptance by the board;
- the board will promptly (within 90 days of the meeting) accept the resignation unless there are extraordinary circumstances relating to the composition of the board or the voting results that should delay the acceptance of the resignation or justify rejecting it;
- the board will make its decision and reasons available to the public.

Further, the CCGG Model Policy provides options to the board to fill a vacancy as a result of a resignation for failing to receive majority support. For example, the board may leave the vacancy open until the following annual meeting, fill the vacancy with a suitable candidate or call a special meeting of shareholders to elect a new director.

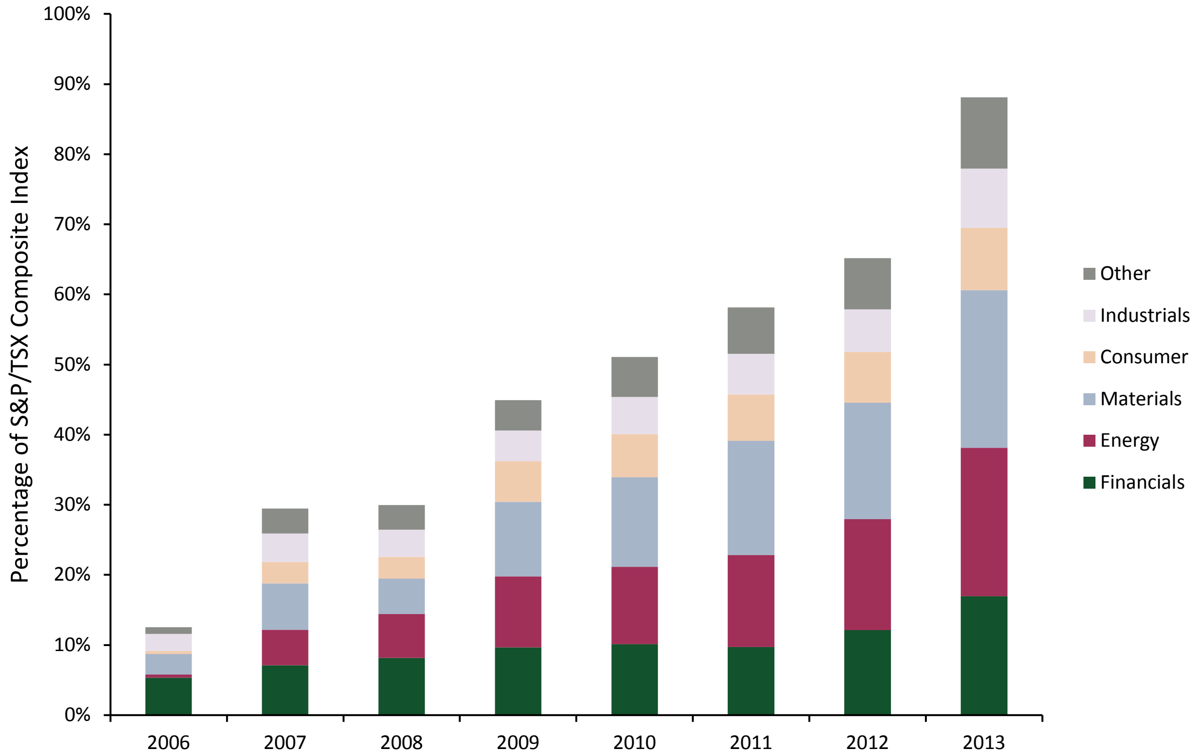
CCGG also launched its "Majority Voting Initiative" in 2011, which focused on companies in the S&P/TSX 60 Index that had not adopted majority voting policies to inform them that its members were prepared to avail themselves of the shareholder proposal mechanism to formally request majority voting for uncontested director elections. The initiative was largely successful and the CCGG expanded its targeted engagements to all companies on the S&P/TSX Composite Index.

2. Voluntary Adoption

(a) Majority voting policies

The following graph illustrates the progress of voluntary adoption of majority voting policies for companies included on the S&P/TSX Composite Index from 2006 to 2013. In its seventh tracked year (2012), majority voting had been adopted by 65% of the S&P/TSX Composite Index, with an average annual increase of 9% between 2006 and 2012. Between 2012 and 2013, however, the rate of voluntary adoption rose by 23% (to a total of 88%). This increase was most likely attributable to the TSX's introduction of a "comply or explain" rule relating to the adoption of majority voting policies (discussed further below).[72]

[72] Following the 2012 Amendments, TSX staff surveyed a cross-section of 200 listed issuers for their compliance with the director election requirements and whether they had adopted a majority voting policy. TSX staff



S&P/TSX Composite Index composition is as of October 15 in each year. Source: Clarkson Centre for Business Ethics & Board Effectiveness. Smaller sectors have been amalgamated for clarity.

The form of majority voting policies adopted in 2006 prior to the publication of the initial CCGG Model Policy varied considerably between issuers. For example, a significant number of the policies did not state that the board would accept a resignation absent extraordinary circumstances that would justify a director in continuing to serve as a board member. Based on our review of 57 companies that adopted a majority voting policy in 2006 and 2007, the table below indicates the percentage of companies whose majority voting policy addressed each of the matters raised in the CCGG Model Policy:

found that 76% of the surveyed issuers had adopted a majority voting policy and that almost 46% of those issuers adopted their policy in 2013.

Director nominee who receives more votes "withheld" than votes "for" will forthwith submit his or her resignation to the board.	93%
Board will refer resignation to appropriate committee for consideration.	77%
Board will promptly accept resignation unless the committee determines there are extraordinary circumstances that would justify a rejection.	32%
It is expected that the resignation will be accepted within 90 days of the meeting.	67%

Despite the consistent increase of the voluntary adoption of majority voting policies by companies included in the S&P/TSX Composite Index, the level of voluntary adoption did not extend to companies below the index despite the CCGG's sustained and persistent efforts in this area. In addition, shareholders were also concerned that many of the majority voting policies adopted did not include the "extraordinary circumstances" provision that limited the board's discretion to refuse to accept a resignation from a director who did not receive at least a majority of the votes cast with respect to his or her election.

(b) The articles or by-laws alternative

The voluntary adoption of majority voting policies in the form recommended by the CCGG was not the only approach. There are also limited examples in Canada where majority voting has been adopted in the company's articles or by-laws.

There is little precedent for special majority requirements for director elections in Canada. One notable exception was Nortel Networks Corporation ("Nortel"). When BCE Inc. spun Nortel out in 2000, Nortel's articles included a provision requiring that directors be elected by a resolution passed by not less than two-thirds of the votes attaching to shares represented in person or by proxy. Pursuant to Nortel's restated certificate of incorporation issued on October 1, 2000:

> Each director of the Corporation shall be elected by a resolution passed by not less than two-thirds of the number of votes attaching to the shares represented in person or by valid proxy at the meeting of shareholders at which the resolution is voted upon and carrying the right to vote on the resolution, as determined and certified by the scrutineers for that meeting or signed by all the shareholders entitled to vote on that resolution.

We understand that the special majority requirement for director elections was initially imposed for corporate and tax structuring purposes. Given the circumstances facing Nortel

following 2001, it did not seek to remove those provisions to return its direction election process to the lesser standard required under the CBCA.

In December 2006, the board of Nexen Inc. adopted a by-law amendment to provide for a modified majority vote standard for director elections. Nexen described the by-law amendment in its management proxy circular for the 2007 annual general and special meeting of shareholders as follows:

> A director who does not receive a majority of the votes cast in favour of his or her election must submit a resignation to the board for consideration. The independent members of the board, on the recommendation of the Governance Committee, determine whether or not to accept the resignation. In considering whether or not to recommend acceptance or rejection of the resignation, the Governance Committee will evaluate the best interest of Nexen and its shareowners and considering a number of factors including any alternatives to cure the underlying cause of the withheld votes, the skills and attributes of the director and the overall composition of the board, including the current mix of skills and attributes of the board, and whether accepting the resignation would cause Nexen to fail to meet any applicable listing or regulatory requirement. Nexen will promptly disclose in a press release the decision of the independent directors and an explanation of how the decision was reached. In the case of a contested election, a plurality standard, which would have those directors who receive the most votes elected, would continue to apply.[73]

Nexen's majority voting by-law was in place until February 25, 2013 when all of its outstanding shares where acquired by CNOOC Limited pursuant to a statutory plan of arrangement. We are aware of one other company that adopted majority voting through a by-law amendment. The by-laws of Industrial Alliance Insurance and Financial Services Inc. provide that directors "shall be elected by a majority vote of shareholders eligible to vote or of participating policyholders, as the case may be."

3. Magna Galvanizes Shareholders on Majority Voting

The commitment of shareholders to giving effect to the majority views of shareholders was the focus of the first director election at Magna International after the collapse of Magna's dual class voting structure in 2010 (as a result of which founder Frank Stronach received an 1800% premium for his voting shares). At its 2011 annual meeting, Magna shareholders voted for individual director candidates, but Magna had not yet adopted a policy of releasing the results of the votes. Three of the Magna's shareholders (Canada Pension Plan Investment Board, RBC Global Asset Management and Connor Clark & Lunn Investment Management Ltd.) sued for release of the results. Magna then released the results voluntarily, which showed that three of the directors had received the support of only 38% of the shareholders.

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[73] Nexen Inc. *Management Information Circular* (March 9, 2007) p. 16, available on SEDAR.

4. OSC Prioritizes Shareholders' Rights and Corporate Governance

Majority voting was just one of the developments in corporate governance in the period following the global financial crisis. The OSC's 2010-11 Statement of Priorities included a commitment to focus on issues relevant to investors at specific stages of the investment process by reviewing protections for shareholder rights and corporate governance. Also in 2011, the OSC published a staff notice on shareholder democracy issues,[74] which highlighted the OSC's commitment to review protections for shareholders' rights and corporate governance and provided an update from OSC staff on the current status of its review. The staff notice identified three issues as requiring additional review and, potentially, the development of regulatory proposals, including majority voting for uncontested director elections, say-on-pay, and the effectiveness of the proxy voting system.

The OSC received 64 comment letters in response to the staff notice. In response to the majority voting issue, supporters of further regulatory action – generally shareholder groups and those who work with them – agreed that the voluntary adoption of majority voting policies was becoming the norm among major Canadian public companies and securities regulators should consider this mandating approach as the minimum regulatory standard for reporting issuers.[75] Some commenters argued that the voluntary adoption majority voting policies in the form recommended by CCGG did not go far enough and amendments to corporate and securities law were necessary to implement binding majority voting.[76] Critics – generally companies and their advisors – did not believe that further regulatory action was necessary in respect of majority voting. While they generally supported majority voting policies as a best practice, they did not see a policy reason for mandating binding majority voting and

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74 OSC Staff Notice 54-701 *Regulatory Developments Regarding Shareholder Democracy Issues* (January 10, 2011), online: <http://www.osc.gov.on.ca/documents/en/Securities-Category5/sn_20110114_54-701_shareholder-democracy.pdf>.

75 See, e.g., Letter from William Mackenzie of Hermes EOS (March 31, 2011) <http://www.osc.gov.on.ca/documents/en/Securities-Category5-Comments/com_20110331_54-701_mackenziew.pdf>; Letter from Marcel Jeucken of PGGM Investments (March 31, 2011) online: <http://www.osc.gov.on.ca/documents/en/Securities-Category5-Comments/com_20110331_54-701_jeuckenm.pdf>.

76 See, e.g., Letter from Wayne Kozun of the Ontario Teachers' Pension Plan (March 31, 2011) <http://www.osc.gov.on.ca/documents/en/Securities-Category5-Comments/com_20110331_54-701_kozunw.pdf>; Letter from David F. Denison of CCGG (March 31, 2011) <http://www.osc.gov.on.ca/documents/en/Securities-Category5-Comments/com_20110331_54-701_denisond.pdf>; Letter from Eleanor Farrell of CPP Investment Board (March 30, 2011) <http://www.osc.gov.on.ca/documents/en/Securities-Category5-Comments/com_20110330_54-701_farrelle.pdf>.

argued that this issue should be left to the board's discretion.[77] Others noted that director elections standards for Canadian companies are a corporate law matter, and securities regulators did not have rulemaking authority to require companies to adopt binding majority voting standards.[78] Some commenters also noted the prevalence of controlled companies in Canada for which majority voting would not influence the outcome of the vote.[79]

5. TSX Imposes Majority Voting Requirement on All of Its Listed Issuers

It was ultimately the TSX that introduced mandatory majority voting for its listed issuers with the support of the OSC. As a recognized exchange, the TSX has the authority to regulate the operations and standards of practice of its members in accordance with its by-laws, rules, policies and practices.[80] The TSX Company Manual contains the original listing requirements and ongoing listing maintenance requirements for companies that are listed for trading on the TSX. Proposed amendments to the listing requirements set out in the TSX Company Manual are overseen by the OSC.

Following the publication of its staff notice on shareholder democracy, the OSC considered ways to address concerns raised about the director election process and determined that working with the TSX to develop a proposal was the most appropriate approach to implement this priority.[81] At the same time, CCGG was also advocating for the TSX to adopt a listing requirement requiring all TSX listed companies to adopt a majority voting policy which states

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[77] See, e.g., Letter of Nathalie Clark from Canadian Bankers Association (March 31, 2011) <http://www.osc.gov.on.ca/documents/en/Securities-Category5-Comments/com_20110331_54-701_clarken.pdf>; Letter from of Donald J. DeGrandis of TransCanada Corporation (March 30, 2011) <http://www.osc.gov.on.ca/documents/en/Securities-Category5-Comments/com_20110330_54-701_degrandisd.pdf>; Letter of Trudy M. Curran from Canadian Oil Sand Limited (March 28, 2011) <http://www.osc.gov.on.ca/documents/en/Securities-Category5-Comments/com_20110328_54-701_currant.pdf>.

[78] See, e.g., Letter from Stan Magidson of the Institute of Corporate Directors (March 28, 2011) <http://www.osc.gov.on.ca/documents/en/Securities-Category5-Comments/com_20110328_54-701_magidsons.pdf>.

[79] See, e.g., Letter from Robert A. Balcom of George Weston Limited (March 31, 2011) <http://www.osc.gov.on.ca/documents/en/Securities-Category5-Comments/com_20110331_54-701_balcomr.pdf>; Letter from Edward Johnson of Power Corporation of Canada (March 31, 2011) <http://www.osc.gov.on.ca/documents/en/Securities-Category5-Comments/com_20110331_54-701_johnsone.pdf>.

[80] OSA, *supra* note 29, s 21(4).

[81] Maureen Jensen, "OSC Strategy in Action", Remarks to the Institute of Corporate Directors (March 20, 2012), online: <http://www.osc.gov.on.ca/documents/en/News/sp_20120320_mj-strategy-action.pdf>.

that the board shall accept a resignation absent extraordinary circumstances.[82] The collaborative effort between the OSC and the TSX was confirmed in the OSC's 2012-13 Statement of Priorities, which included the commitment to "facilitate shareholder empowerment in director elections by advocating for the elimination of slate voting, the adoption of majority voting policies for director elections and enhancing disclosure of voting results for shareholder meetings."[83]

(a) TSX's initial "comply or explain" disclosure approach

On October 4, 2012 the TSX published amendments to Part IV of the TSX Company Manual (the "2012 Amendments") requiring TSX listed companies to elected directors individually and hold annual elections for all directors. These amendments are similar to existing expectations for companies listed on the TSXV.[84]

With respect to majority voting, the 2012 Amendments did not mandate the adoption of a majority voting policy, but applied a "comply or explain" disclosure approach requiring TSX listed companies to:

- disclose annually in their materials sent to shareholders in connection with a meeting at which directors are being elected: (a) whether they have adopted a majority voting policy for directors at uncontested meetings; and (b) if not, explain their practices for electing directors and explain why they have not adopted a majority voting policy;
- advise TSX if a director receives a majority of "withhold" votes (if a majority voting policy has not been adopted); and
- promptly issue a news release providing detailed voting results for the election of directors.[85]

The 2012 Amendments came into force on December 31, 2012. As explained in the initial request for comment,[86] the TSX proposed the "comply or explain" disclosure model as a

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82 CCGG, *2013 Annual Report: Improving Corporate Governance in Canada* (June 2014), online: <http://www.ccgg.ca/site/ccgg/assets/pdf/2013_annual_report_published_on_june_3,_2014.pdf >.

83 OSC Notice 11-767 *Notice of Statement of Priorities for Financial Year to End March 31, 2013* (June 28, 2012), online: <http://www.osc.gov.on.ca/documents/en/Securities-Category1/sn_20120628_11-767_sop-fiscal-2012-2013.pdf>.

84 Section 19.6 of TSXV Policy 3.1 "Directors, Officers, Other Insiders & Personnel and Corporate Governance" provides that issuers should avoid mechanisms that entrench existing management such as staggered elections of the board of directors or the election of a slate of directors.

85 Notice of Approval, *Amendments to Part IV of the Toronto Stock Exchange ("TSX") Company Manual* (October 4, 2012) <http://tmx.complinet.com/en/display/display_main.html?rbid=2072&element_id=808>.

starting point and undertook to monitor the voluntary adoption of majority voting policies to determine whether further action would be more appropriate at a later point. However, a number of commentators believed that the "comply or explain" disclosure approach did not go far enough and mandatory requirements were necessary. As a result, together with the notice of approval of the 2012 Amendments, the TSX published for comment public interest amendments to the TSX Company Manual to mandate majority voting for all TSX listed companies, with a view to having the amendments become effective during the 2014 proxy season.[87]

(b) TSX Makes Majority Voting Mandatory

On February 13, 2014, the TSX finalized the public interest rule amendments (the "2014 Amendments") requiring TSX listed companies to implement majority voting for all uncontested director elections.[88] The stated purpose of the 2014 Amendments was to "improve corporate governance standards in Canada by providing a meaningful way for security holders to hold individual directors accountable" and to "enhance transparency and improve governance dialogue between issuers, security holders and other stakeholders."[89]

The 2014 Amendments are substantially similar to the CCGG Model Policy. They require each director of a TSX listed company, other than a majority controlled company,[90] to be elected by a majority of votes cast at an uncontested meeting. Further, the 2014 Amendments require a TSX listed companies to adopt majority voting policies (unless they otherwise satisfy the majority voting requirements through their statutes of incorporation, articles or by-laws) that provide for the following:

- a director who does not receive a majority of votes cast in respect of his or her election must immediately tender his or her resignation to the board of directors;

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86 Request for Comment, *Amendments to Part IV of the Toronto Stock Exchange ("TSX") Company Manual* (September 9, 2011) <http://tmx.complinet.com/en/display/display.html?rbid=2072&element_id=791>.

87 Request for Comment, *Amendments to Part IV of the Toronto Stock Exchange ("TSX") Company Manual* (October 4, 2012) <http://tmx.complinet.com/en/display/display_main.html?rbid=2072&element_id=821>.

88 Notice of Approval, *Amendments to Part IV of the Toronto Stock Exchange Company Manual* (February 13, 2014) <http://tmx.complinet.com/en/display/display_main.html?rbid=2072&element_id=859>.

89 *Ibid*.

90 "Majority controlled" is defined as a security holder or company that beneficially owns, or controls or directs, directly or indirectly, voting securities carrying 50 % or more of the voting rights (of a class or series) for the election of directors, as of the record date for the meeting.

- the board must determine whether or not to accept the resignation within 90 days after the date of the shareholders' meeting, and must accept the resignation absent exceptional circumstances;
- the resignation will be effective when accepted by the board;
- a director who tenders a resignation may not participate in any meeting of the board or committee at which the resignation is considered; and
- the listed issuer must promptly issue a news release stating the board's decision and, if the board determines not to accept a resignation, fully state the reasons explaining the board's decision.[91]

The 2014 Amendments became effective on June 30, 2014.

[91] *TSX Company Manual*, s. 461.3, online: <tmx.complinet.com/en/tsx_manual.html>.

SCHEDULE D
Background to Majority Voting in the United States

The Schedule outlines the history leading to the rise of majority voting in the U.S. and the background to the amendments made to the Delaware statute and the Model Act that are discussed in section 2.9 of this Discussion Paper.

Most corporate statutes in the U.S. provide that directors are elected based on a plurality of votes represented in person and by proxy at the meeting. Majority voting emerged as an issue in the U.S. following the crisis in governance arising from the Enron style accounting scandals and the dotcom crash, but like many governance developments, it had much deeper roots.

The expectations of shareholders for corporate governance and increased director accountability follows concerns in the late 80s and early 90s at several large U.S. public companies regarding poor corporate and CEO performance. In 1985, several large institutional investors formed the CII and adopted a "Shareholder Bill of Rights" calling for, among others, independent oversight of executive compensation and auditing. The same year, ISS was founded to provide corporate governance rating services and guidance to investors in respect of their proxy voting decisions.

In a 1990 speech to the annual fall meeting of CII,[92] former SEC commissioner Joseph Grundfest argued that a high percentage of votes withheld from the board in contested director elections could act as a catalyst for governance and operating changes at underperforming companies. Despite the fact that the vote would not affect the outcome of the election under a plurality voting standard, Grundfest argued that directors who are concerned about their reputational capital would be more likely to stand up to CEOs and become more responsible to shareholders' interests. The solution proposed by Grundfest was "just vote no" campaigns. In other words, efforts from shareholders to persuade other shareholders to withhold votes from directors up for election in an effort to communicate shareholder dissatisfaction to the board.

In early 2003, the SEC directed staff to review and formulate possible changes in the proxy rules regarding procedures for the election of directors.[93] The direction followed concerns over the accountability of directors as a result of governance failures at Enron, WorldCom and other entities in 2001 and 2002. SEC staff published a report in July 2003 (the "Staff Report"), which

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92 Grundfest, J. A., "Just Vote No or Just Don't Vote: Minimalist Strategies for Dealing with Barbarians Inside the Gates, Presentation Before the Fall Meeting of the Council of Institutional Investors" (Nov. 7, 1990) discussed in Ferri F., "'Low-Cost' Shareholder Activism: A Review of the Evidence (December 2010) Columbia Business School <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1718495>.

93 Securities and Exchange Commission, Press Release No. 2003-46 (April 14, 2003).

discussed alternatives for increasing shareholder participation in the proxy process regarding the nomination and election of directors.[94] The Staff Report ultimately recommended that the SEC propose and solicit public comment with regard to proposed changes in respect of two alternatives. The first area was disclosure enhancements regarding nominating committees and shareholder communications with board members.[95] The second area was to improve shareholder access to the director nomination process, which would allow a shareholder or a group of shareholders to place their nominees on the company's proxy materials within specific parameters – generally referred to as "proxy access".

Proxy access was – and continues to be – controversial in the U.S. Still, there was a need for change in director elections. In 2004, while the debate on proxy access continued, three prominent governance experts – Joseph Grundfest, Ira Millstein and Norman Veasey – proposed some form of majority voting for director elections (either through stock exchange listing standards, amendments to state incorporation laws or corporate by-law).[96]

During 2005, the progress towards majority voting was rapid. In February 2005, the ABA created a task force to consider the issue of majority voting (the "ABA Task Force"). In its preliminary report, published on January 17, 2006 the ABA Task Force concluded that the potential consequences for "failed elections" for some corporations and other concerns did not support a universally applicable change in the statutory plurality default rule. Moreover, the ABA Task Force believed that imposing a "one size fits all" change to the existing statutory system would be inconsistent with the enabling nature of state incorporation laws, including the Model Act. Instead, the ABA Task Force recommended amendments to the Model Act to facilitate alternative director election standards which could be adopted through private ordering.

In 2005, CII wrote to 1,500 corporations requesting that they adopt majority voting. On June 15 and 22, 2005, CII and the CalPERS wrote nearly identical letters requesting that the Delaware statute be amended to provide majority voting as the default rule for director elections of public corporations. The ICGN made majority voting one of its key advocacy priorities during its 2005 annual meeting. During the 2006 proxy season, ISS published a policy statement regarding majority voting, indicating that it would support nonbinding shareholder

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94 Securities and Exchange Commission, Division of Corporation Finance, *Staff Report: Review of the Proxy Process Regarding the Nomination and Election of Directors* (July 15, 2003), online: <https://www.sec.gov/news/studies/proxyreport.pdf>.

95 This recommendation resulted in the proposal Release No. 34-48301, *Disclosure Regarding Nominating Committee Functions and Communications between Security Holders and Boards of Directors* (August 14, 2003), online: <https://www.sec.gov/rules/proposed/34-48301.htm>.

96 Joseph A. Grundfest, *Advice and Consent: An Alternative Mechanism for Shareholder Participation in the Nomination and Election of Corporate Directors*, Harvard University Press (2004), online: <https://www.sec.gov/spotlight/dir-nominations/grundfest032004.pdf>.

proposals calling for directors to be elected by a majority of votes cast in the director's election, provided the proposal included a carve-out for contested director elections. Over the course of the 2005 and 2006 proxy seasons, a number of shareholder proposals were filed asking that publicly traded companies in the U.S. implement majority voting in uncontested director elections. These proposals were also well supported by shareholders. In 2005, 84 shareholder proposals were submitted and averaged 44% support while in 2006, 96 proposals were submitted and averaged 49% support.[97] The average rate of support for the approximately 150 majority voting shareholder proposals filed during the 2007 proxy season was in excess of 50%. Additionally in 2007, 66% of the S&P 500 companies had instituted some form of majority voting, whether through a non-binding corporate governance policy or a by-law amendment.[98] In each year since 2007, average support for shareholder proposals requesting majority voting exceeded 50%. Average support has grown from 50.4% of votes cast "for" to 73 % in 2016.[99]

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97 Claudia H. Allen, *Study of Majority Voting in Director Elections*, Neal, Gerber & Eisenberg LLP, ii–iii (Nov. 12, 2007), online: <http://www.ngelaw.com/files/upload/ majoritystudy111207.pdf>.

98 *Ibid*.

99 CII Majority Voting FAQ, *supra* note 24 at p. 3.

SCHEDULE E
Majority Voting Provisions in Delaware and Under the Model Act

Delaware General Corporation Law

§ 109 By-laws.

(a) The original or other by-laws of a corporation may be adopted, amended or repealed by the incorporators, by the initial directors of a corporation other than a nonstock corporation or initial members of the governing body of a nonstock corporation if they were named in the certificate of incorporation, or, before a corporation other than a nonstock corporation has received any payment for any of its stock, by its board of directors. After a corporation other than a nonstock corporation has received any payment for any of its stock, the power to adopt, amend or repeal by-laws shall be in the stockholders entitled to vote. In the case of a nonstock corporation, the power to adopt, amend or repeal by-laws shall be in its members entitled to vote. Notwithstanding the foregoing, any corporation may, in its certificate of incorporation, confer the power to adopt, amend or repeal by-laws upon the directors or, in the case of a nonstock corporation, upon its governing body. The fact that such power has been so conferred upon the directors or governing body, as the case may be, shall not divest the stockholders or members of the power, nor limit their power to adopt, amend or repeal by-laws.

§ 141 Board of directors; powers; number, qualifications, terms and quorum; committees; classes of directors; nonstock corporations; reliance upon books; action without meeting; removal.

(b) The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation. If any such provision is made in the certificate of incorporation, the powers and duties conferred or imposed upon the board of directors by this chapter shall be exercised or performed to such extent and by such person or persons as shall be provided in the certificate of incorporation.

(c) The board of directors of a corporation shall consist of 1 or more members, each of whom shall be a natural person. The number of directors shall be fixed by, or in the manner provided in, the by-laws, unless the certificate of incorporation fixes the number of directors, in which case a change in the number of directors shall be made only by amendment of the certificate. Directors need not be

stockholders unless so required by the certificate of incorporation or the by-laws. The certificate of incorporation or by-laws may prescribe other qualifications for directors. Each director shall hold office until such director's successor is elected and qualified or until such director's earlier resignation or removal. Any director may resign at any time upon notice given in writing or by electronic transmission to the corporation. A resignation is effective when the resignation is delivered unless the resignation specifies a later effective date or an effective date determined upon the happening of an event or events. A resignation which is conditioned upon the director failing to receive a specified vote for re-election as a director may provide that it is irrevocable. A majority of the total number of directors shall constitute a quorum for the transaction of business unless the certificate of incorporation or the by-laws require a greater number. Unless the certificate of incorporation provides otherwise, the by-laws may provide that a number less than a majority shall constitute a quorum which in no case shall be less than 1/3 of the total number of directors. The vote of the majority of the directors present at a meeting at which a quorum is present shall be the act of the board of directors unless the certificate of incorporation or the by-laws shall require a vote of a greater number.

§ 216 Quorum and required vote for stock corporations.

Subject to this chapter in respect of the vote that shall be required for a specified action, the certificate of incorporation or by-laws of any corporation authorized to issue stock may specify the number of shares and/or the amount of other securities having voting power the holders of which shall be present or represented by proxy at any meeting in order to constitute a quorum for, and the votes that shall be necessary for, the transaction of any business, but in no event shall a quorum consist of less than 1/3 of the shares entitled to vote at the meeting, except that, where a separate vote by a class or series or classes or series is required, a quorum shall consist of no less than 1/3 of the shares of such class or series or classes or series. In the absence of such specification in the certificate of incorporation or by-laws of the corporation:

(1) A majority of the shares entitled to vote, present in person or represented by proxy, shall constitute a quorum at a meeting of stockholders;

(2) In all matters other than the election of directors, the affirmative vote of the majority of shares present in person or represented by proxy at the meeting and entitled to vote on the subject matter shall be the act of the stockholders;

(3) Directors shall be elected by a plurality of the votes of the shares present in person or represented by proxy at the meeting and entitled to vote on the election of directors; and

(4) Where a separate vote by a class or series or classes or series is required, a majority of the outstanding shares of such class or series or classes or series, present in person or represented by proxy, shall constitute a quorum entitled to take action with respect to that vote on that matter and, in all matters other than the election of directors, the affirmative vote of the majority of shares of such class or series or classes or series present in person or represented by proxy at the meeting shall be the act of such class or series or classes or series.

A by-law amendment adopted by stockholders which specifies the votes that shall be necessary for the election of directors shall not be further amended or repealed by the board of directors.

§ 223 Vacancies and newly created directorships.

(a) Unless otherwise provided in the certificate of incorporation or by-laws:

(1) Vacancies and newly created directorships resulting from any increase in the authorized number of directors elected by all of the stockholders having the right to vote as a single class may be filled by a majority of the directors then in office, although less than a quorum, or by a sole remaining director;

(2) Whenever the holders of any class or classes of stock or series thereof are entitled to elect 1 or more directors by the certificate of incorporation, vacancies and newly created directorships of such class or classes or series may be filled by a majority of the directors elected by such class or classes or series thereof then in office, or by a sole remaining director so elected.

If at any time, by reason of death or resignation or other cause, a corporation should have no directors in office, then any officer or any stockholder or an executor, administrator, trustee or guardian of a stockholder, or other fiduciary entrusted with like responsibility for the person or estate of a stockholder, may call a special meeting of stockholders in accordance with the certificate of incorporation or the by-laws, or may apply to the Court of Chancery for a decree summarily ordering an election as provided in § 211 or § 215 of this title.

(b) In the case of a corporation the directors of which are divided into classes, any directors chosen under subsection (a) of this section shall hold office until the next election of the class for which such directors shall have been chosen, and until their successors shall be elected and qualified.

(c) If, at the time of filling any vacancy or any newly created directorship, the directors then in office shall constitute less than a majority of the whole board (as constituted immediately prior to any such increase), the Court of Chancery

may, upon application of any stockholder or stockholders holding at least 10 percent of the voting stock at the time outstanding having the right to vote for such directors, summarily order an election to be held to fill any such vacancies or newly created directorships, or to replace the directors chosen by the directors then in office as aforesaid, which election shall be governed by § 211 or § 215 of this title as far as applicable.

(d) Unless otherwise provided in the certificate of incorporation or by-laws, when 1 or more directors shall resign from the board, effective at a future date, a majority of the directors then in office, including those who have so resigned, shall have power to fill such vacancy or vacancies, the vote thereon to take effect when such resignation or resignations shall become effective, and each director so chosen shall hold office as provided in this section in the filling of other vacancies.

Model Business Corporations Act

§ 7.28. Voting for Directors; Cumulative Voting

(a) Unless otherwise provided in the articles of incorporation, directors are elected by a plurality of the votes cast by the shares entitled to vote in the election at a meeting at which a quorum is present.

§ 8.07. Resignation of Directors

(a) A director may resign at any time by delivering a written resignation to the board of directors, or its chair, or to the secretary of the corporation.

(b) A resignation is effective when the resignation is delivered unless the resignation specifies a later effective date or an effective date determined upon the happening of an event or events. A resignation that is conditioned upon failing to receive a specified vote for election as a director may provide that it is irrevocable.

§ 8.10. Vacancy on Board

(a) Unless the articles of incorporation provide otherwise, if a vacancy occurs on a board of directors, including a vacancy resulting from an increase in the number of directors:

(1) the shareholders may fill the vacancy;

(2) the board of directors may fill the vacancy; or

(3) if the directors remaining in office constitute fewer than a quorum of the board, they may fill the vacancy by the affirmative vote of a majority of all the directors remaining in office.

(b) If the vacant office was held by a director elected by a voting group of shareholders, only the holders of shares of that voting group are entitled to vote to fill the vacancy if it is filled by the shareholders, and only the directors elected by that voting group are entitled to fill the vacancy if it is filled by the directors.

(c) A vacancy that will occur at a specific later date (by reason of a resignation effective at a later date under section 8.07(b) or otherwise) may be filled before

the vacancy occurs but the new director may not take office until the vacancy occurs.

§ 10.22. **By-law Provisions Relating to the Election of Directors**

(a) Unless the articles of incorporation (i) specifically prohibit the adoption of a by-law pursuant to this section, (ii) alter the vote specified in section 7.28(a), or (iii) provide for cumulative voting, a public corporation may elect in its by-laws to be governed in the election of directors as follows:

(1) each vote entitled to be cast may be voted for or against up to that number of candidates that is equal to the number of directors to be elected, or a shareholder may indicate an abstention, but without cumulating the votes;

(2) to be elected, a nominee must have received a plurality of the votes cast by holders of shares entitled to vote in the election at a meeting at which a quorum is present, provided that a nominee who is elected but receives more votes against than for election shall serve as a director for a term that shall terminate on the date that is the earlier of (i) 90 days from the date on which the voting results are determined pursuant to section 7.29(b) (5) or (ii) the date on which an individual is selected by the board of directors to fill the office held by such director, which selection shall be deemed to constitute the filling of a vacancy by the board to which section 8.10 applies. Subject to clause (3) of this section, a nominee who is elected but receives more votes against than for election shall not serve as a director beyond the 90-day period referenced above; and

(3) the board of directors may select any qualified individual to fill the office held by a director who received more votes against than for election.

(b) Subsection (a) does not apply to an election of directors by a voting group if (i) at the expiration of the time fixed under a provision requiring advance notification of director candidates, or (ii) absent such a provision, at a time fixed by the board of directors which is not more than 14 days before notice is given of the meeting at which the election is to occur, there are more candidates for election by the voting group than the number of directors to be elected, one or more of whom are properly proposed by shareholders. An individual shall not be considered a candidate for purposes of this subsection if the board of directors determines before the notice of meeting is given that such individual's candidacy does not create a bona fide election contest.

(c) A by-law electing to be governed by this section may be repealed:

(1) if originally adopted by the shareholders, only by the shareholders, unless the by-law otherwise provides;

(2) if adopted by the board of directors, by the board of directors or the shareholders.

SCHEDULE F
Consultation Process

This is not the first time that legislative changes are being proposed to the CBCA. In the lead up to prior revisions, however, the Government undertook significantly broader consultations. Those consultations permitted advice and consideration from a wide cross-section of the business community. They also afforded time for the community to consider and discuss the proposed changes and the range of consequences that may flow from them, so as to be able to provide meaningful comment and assistance to government. The process leading to the current CBCA Amendments regrettably did not include the broad consultations undertaken in past revisions.

The following outlines the process leading to the CBCA Amendments set out in Bill C-25 and the processes followed in earlier revisions, contrasting the significant differences in approaches.

1. Consultation process followed for Bill C-25

The first Industry Canada discussion paper was published in 2004 and contained proposals for strengthening corporate governance of publicly-traded corporations and promoting investor confidence.[100] The proposals were aimed at increasing the independence of boards from management through measures such as having a majority of independent directors, separating the board chair and CEO positions and requiring independent audit, nomination and compensation committees. A second discussion paper published in 2007, which was issued jointly by Industry Canada and the Department of Finance, sought feedback on a number of issues related to securities transfer rules.[101]

The House of Commons Standing Committee on Industry, Science and Technology completed the mandated five-year statutory review of the CBCA in 2009-10.[102] During their testimony to the Committee as part of the CBCA five-year review, Industry Canada officials gave a summary of the stakeholder feedback received from their consultations. In particular, the officials stated there was no consensus on the proposals and, given the issues in the 2004 discussion paper

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[100] Industry Canada, *Towards an Improved Standard of Corporate Governance for Federally Incorporated Companies: Proposals for Amendments to the Canada Business Corporations Act* (May 2004).

[101] Industry Canada and Finance Canada, *Modernizing the Legal Framework for Financial Transactions: Reforming Federal Securities Transfer Rules* (June 2007), online: <http://www.fin.gc.ca/activty/consult/modsectr_1-eng.asp>.

[102] Hon. Michael Chong, *Statutory Review of the Canada Business Corporations Act: Report of the Standing Committee on Industry, Science and Technology* (June 2010) 40th Parliament, 3rd Session, online: <http://www.parl.gc.ca/content/hoc/Committee/403/INDU/Reports/RP4591866/indurp04/indurp04-e.pdf>.

related only to public companies, many stakeholders felt that the securities regulators were better suited to deal with these matters. The Committee's report recommended that the Government consult on four issues:

- rules relating to the disclosure of executive compensation;
- rules applicable to shareholder voting and participation rights;
- rules regarding the holding and transfer of shares and insider trading; and
- rules applicable to the incorporation of socially responsible enterprises.

In 2014, Industry Canada undertook a public consultation on the CBCA and published a discussion paper describing the issues under consideration.[103] The purpose of the public consultation was to ensure that the governance framework for CBCA corporations "remains effective, fosters competitiveness, supports investments and entrepreneurial activity, and investor and business confidence". The issues under review were broad and varied. They included the four recommendations from the Committee's 2010 report and a number of other issues that reflected emerging developments in corporate governance. In addition to majority voting, the topics included the diversity of board members, combatting bribery and corruption, take-over bid rules, the use of the arrangement provisions of the CBCA and corporate social responsibility. Industry Canada received 82 comment letters in response to the public consultation. Comments in respect of majority voting did not amount to a broad consensus and ranged between support from the investor community to concerns raised by public companies and their advisors.

Given the breadth of topics that were initially contemplated, it is not clear why the legislature ultimately drafted amendments that focused on majority voting, nor was there opportunity for meaningful consultation on this specific issue.

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[103] *Consultation on the Canada Business Corporations Act* (Ottawa: Industry Canada, 2014) online: <https://www.ic.gc.ca/eic/site/cilp-pdci.nsf/eng/h_cl00867.html>.

2. Consultation process followed for previous amendments

By way of comparison, we have set out below, the extensive consultation processes followed for other amendments to the CBCA.

The CBCA was first enacted in 1975. In 1994, Parliament approved Bill C-12, the first phase of amendments to the CBCA. These amendments were of a technical nature.[104] The legislature received submissions on this Bill,[105] but it enacted the technical reforms quickly while commencing consultations for more substantive changes to the CBCA, which it referred to as "Phase II".[106]

Bill C-12, which was approved in 1994, required the Minister of Industry to submit recommendations on further, more substantive changes to Parliament by June 1997. The following issues were identified for discussion with stakeholders during Phase II:

- the liability of corporate directors, corporate auditors and others associated with a corporation;
- shareholder communications, both between a corporation and its shareholders and also among shareholders;
- citizenship and residency requirements imposed on boards of directors and on board committees;

[104] Standing Senate Committee on Banking, Trade and Commerce, *Corporate Governance* (Ottawa: Queen's Printer, August 1996) (Chairman: The Hon. M. Kirby; Deputy Chainman: The Hon. W.D. Angus), online: <https://sencanada.ca/content/sen/committee/352/bank/rep/cgo-e.htm> [Senate Report]; see also Bill C-12, *An Act to amend the Canada Business Corporations Act and to make consequential amendments to other Acts*, 1st Sess, 35th Parl, 1994, online: <http://www.parl.gc.ca/HousePublications/Publication.aspx?Language=E&Mode=1&DocId=2328249&File=6>.

[105] Technical Amendments Discussion Paper, *supra* note 33; online: <http://publications.gc.ca/collections/Collection/C2-280-4-1995E.pdf>; see also Canadian Bar Association – National Business Law Section, *Commentary to the Sub-Committee on Industry of the Standing Committee on Bill C-12: an Act to amend the Canada Business Corporations Act and to make consequential amendments to other acts* (Ottawa: Canadian Bar Association, 1994) at 3, noting that the National Business Law Section of the Canadian Bar Association had discussed the entire Bill and each of its specific provisions with various officials of the Department of Industry and Science both recently and at a conceptual level over several years.

[106] House of Commons Debates, 35th Parl, 1st Sess, No. 63 (4 May 1994) at 1710, online: <http://www.parl.gc.ca/HousePublications/Publication.aspx?Language=E&Mode=1&Parl=35&Ses=1&DocId=2332318>.

- financial assistance granted by the corporation to directors, officers, shareholders and others;
- insider trading rules; and
- rules governing takeover bids.[107]

A series of nine discussion papers was released in 1995 and 1996 on various issues relating to the CBCA,[108] which included the above substantive topics, as well as technical amendments, which addressed submissions that had been made on the 1994 amendments that were outside the scope of Bill C-12.[109]

Industry Canada also put out a backgrounder that listed a number of specific questions for stakeholders to address during consultations on these topics, and the Senate Committee on Banking, Trade and Commerce (the "Committee") held hearings in five cities, receiving submissions and hearing from 59 witnesses, members of Canada's corporate community who came forward upon invitation from the Committee.[110]

Following this process, further consultations were held to develop a consensus on reform proposals, and updates to many of the initial discussion papers were published.[111] This ultimately led to Bill S-11, which amended the CBCA in 2001 to achieve the following goals:

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107 Senate Report, *supra* note 110.

108 Gérald Lafreniere, Margaret Smith, *Bill S-11:* An Act to Amend the Canada Business Corporations Act and the Canada Cooperatives Act and to Amend Other Acts (Ottawa: Parliament of Canada, 2001) online: <http://www.lop.parl.gc.ca/About/Parliament/LegislativeSummaries/bills_ls.asp?lang=E&ls=S11&Parl=37&Ses=1&source=Bills_Senate_Government#(1)txt>.

109 Industry Canada, *Canada Business Corporations Act, Discussion Paper, Proposals for Technical Amendments* (Ottawa: Industry Canada, September 1995), online: <http://publications.gc.ca/collections/Collection/C2-280-4-1995E.pdf>.

110 Senate Report, *supra* note 110.

111 Industry Canada, *Canada Business Corporations Act, Discussion Paper, Directors' Liability* (Ottawa: Industry Canada, November 1995) was updated February 29, 2000, online: <http://publications.gc.ca/Collection-R/LoPBdP/BP/prb9944-e.htm>; Industry Canada, *Canada Business Corporations Act, Discussion Paper, Directors' and Other Corporate Residency Issues* (Ottawa: Industry Canada, August 1995) was updated December 7, 1999, online: <http://www.lop.parl.gc.ca/content/lop/researchpublications/prb9931-e.htm>; Industry Canada, *Canada Business Corporations Act, Discussion Paper, Insider Trading* (Ottawa: Industry Canada, February 1996) was updated December 22, 1999, online: <http://publications.gc.ca/Collection-R/LoPBdP/BP/prb9938-e.htm>; Industry Canada, *Canada Business Corporations Act, Discussion Paper, Shareholder Communications and Proxy Solicitation Rules* (Ottawa: Industry Canada, August 1995) was updated January 18, 2000, online: <http://www.lop.parl.gc.ca/content/lop/ResearchPublications/prb9933-e.pdf>; Industry Canada, *Canada Business Corporations Act, Discussion Paper, Take-over Bids* (Ottawa: Industry Canada, February 1996) was updated January 25, 2000, online: <http://publications.gc.ca/collections/Collection-R/LoPBdP/BP/prb9940-e.htm>; Industry Canada, *Canada*

- to expand the rights of shareholders to participate in the major decisions of their corporation – for example, by allowing non-registered shareholders to submit proposals and by modifying the grounds for rejecting a shareholder proposal; by allowing increased communication between shareholders; by expanding the means for shareholders to solicit proxies; and by allowing electronic communication between a corporation and shareholders;

- to enhance global competitiveness – for example, by reducing the residency requirements for the board of directors and eliminating the residency requirement for committees of the board; and by establishing a due diligence defence for directors rather than the current "good faith reliance" defence;

- to clarify responsibility – for example, by establishing a regime of modified proportionate liability for those involved in the preparation of financial information required by the CBCA and by clarifying the rules regarding unanimous shareholder agreements;

- to eliminate duplication and reduce costs – in part by eliminating duplication with provincial securities legislation; and

- to make a series of technical amendments.[112]

Following the 2001 amendments, Industry Canada published two discussion papers for comment on possible further amendments to the CBCA and consulted with stakeholders. However, these consultations did not result in any proposals for changes.

We recognize that the above issues are important and warrant serious consideration. However, the implications of the current proposed amendments are equally significant and deserving of serious discussion and consideration.

Business Corporations Act, Discussion Paper, Financial Assistance and Related Provisions, (Ottawa: Industry Canada, March 1996), was updated January 26, 2000, online: <http://publications.gc.ca/Collection-R/LoPBdP/BP/prb9941-e.htm#(2)>.

[112] Gérald Lafreniere, Margaret Smith, *Bill S-11:* An Act to Amend the Canada Business Corporations Act and the Canada Cooperatives Act and to Amend Other Acts (Ottawa: Parliament of Canada, 2001) online: <http://www.lop.parl.gc.ca/About/Parliament/LegislativeSummaries/bills_ls.asp?lang=E&ls=S11&Parl=37&Ses=1&source=Bills_Senate_Government#(1)txt>.

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