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The International Comparative Legal Guide to:

Corporate Governance 2013

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A practical cross-border insight into corporate governance

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The International Comparative Legal Guide to: Corporate Governance 2013

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Canada

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1 Setting the Scene - Sources and Overview

1.1 What are the main corporate entities to be discussed?

This Chapter discusses corporations in Canada, with a focus on public companies and with the intention that private corporations will find it useful in structuring and measuring their own governance frameworks.

1.2 What are the main legislative, regulatory and other corporate governance sources?

The principal sources of corporate governance requirements in Canada are corporate legislation, securities legislation, stock exchange rules and the common law. In addition, shareholder advocacy groups and proxy advisory services, including the Canadian Coalition for Good Governance ("CCGG"), Institutional Shareholders Services Inc. ("ISS"), Glass Lewis & Co. ("Glass Lewis") and the Institute of Corporate Directors (the "ICD"), are influential through their publication of policy statements and guidelines. These organisations have become a reference point for many Canadian companies on best practices for corporate governance. Recourse is often also had to concepts of and commentary on corporate social responsibility, general business ethics and the basic tenets of strategic planning, risk management, engagement, accountability, transparency, efficiency and effectiveness.

Corporate Legislation

Under federal and provincial corporate statutes, directors must manage, or supervise the management of, the business and affairs of the corporation, although directors may delegate certain matters to board committees or to officers. Directors have a legal duty to act honestly and in good faith with a view to the best interests of the corporation and exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

In general, a corporation in Canada is incorporated by filing articles of incorporation (or similar charter documents) with the appropriate federal or provincial government authority. The articles of incorporation specify certain corporate governance matters, which may include the maximum and minimum number of directors, any restrictions on the business that the corporation may carry on and any rights attaching to each class of shares. Usually, corporations also enact by-laws (or similar documents) which address more procedural issues, such as quorum at meetings and authority of corporate officers.

Securities Legislation

National Policy 58-201 – *Corporate Governance Guidelines* ("NP 58-201") sets guidelines for most public companies in Canada in respect of governance matters, including the composition and mandate of the board of directors, director independence, development of position descriptions for directors and officers, codes of conduct, nomination and remuneration of directors, and performance assessment of the board and individual directors. Companies must disclose information about their corporate governance practices in accordance with National Instrument 58-101 – *Disclosure of Corporate Governance Practices* ("NI 58-101"). In general, Canadian securities regulators require that corporations comply with the guidelines in NP 58-201 or explain their lack of compliance in their public disclosure.

Canadian securities regulators have proposed a new mandatory governance and disclosure regime tailored specifically for venture issuers that has not yet come into force at the time of writing, National Instrument 51-103 – *Ongoing Governance and Disclosure Requirements for Venture Issuers*.

Stock Exchange Rules

Public companies listed on the Toronto Stock Exchange (the "TSX") are required to comply with the provisions in the TSX Company Manual (the "Manual") related to corporate governance and to seek shareholder approval for certain transactions (in particular those that represent a fundamental change to the business or will result in extraordinary dilution). Generally, the requirements of the Manual align with NP 58-101 and NI 58-201. In addition, corporations listed on the TSX Venture Exchange (the emerging company exchange of the TSX) must also comply with Corporate Finance Manual Policy 3.1 – *Directors, Officers, Other Insiders & Personnel and Corporate Governance*.

Common Law

Directors' and officers' duties and conduct, shareholder rights and obligations, fiduciary duties and other corporate governance matters are increasingly addressed by a sometimes "made in Canada" approach in case law.

1.3 What are the current topical issues, developments, trends and challenges in corporate governance?

Shareholder Democracy

Shareholder activism continues to be an important trend, demonstrated by more frequent shareholder proposals and an increasing level of engagement between shareholder activists and management.

Effective as of December 31, 2012, the TSX amended the Manual to provide that directors must be elected individually (rather than by slate election) and re-elected on an annual basis. TSX-listed companies must also now provide detailed disclosure of annual meeting voting results and provide "comply or explain" disclosure in their management information circulars regarding the adoption of majority voting policies for the election of directors at uncontested meetings. For 2013, ISS recommended that shareholders withhold votes from all directors nominated by slate ballot and Glass Lewis recommended that shareholders withhold votes from the members of the corporate governance committee if the issuer has not adopted majority voting.

With the rise in shareholder activism, an increasing number of listed companies have recently implemented advance notice policies, which generally require that notice of director nominations and detailed information about nominees and dissident shareholders be provided to management in advance of a shareholder meeting. The advance notice policy has become an important mechanism to protect companies from activist shareholders who might otherwise attempt to ambush a shareholders' meeting by making a surprise motion to nominate directors. The advance notice policy device has now received endorsement from the Supreme Court of British Columbia, as well as ISS and Glass Lewis.

Executive Compensation and "Say on Pay"

Canadian securities regulators have amended the executive compensation disclosure requirements for public companies, which restrict the circumstances in which companies may omit disclosure of performance goals and require additional disclosure with respect to the experience of compensation committee members, compensation practice risk, upcoming changes to corporate compensation policies, hedging by directors and officers, and compensation consultant fees.

The number of listed issuers who put a say on pay vote to their shareholders has grown significantly over the years to include a large majority of companies listed on the S&P/TSX 60 (an index of 60 large companies listed on the TSX). However, the adoption of say on pay practices has made much slower progress among other TSX-listed companies. While say on pay has become mandatory in many jurisdictions, it remains to be seen whether Canada will align its governance practices in this regard in the future.

Notice-and-Access

Public companies in Canada now have the option to post shareholder meeting materials and certain continuous disclosure information on the internet ("notice-and-access"), rather than mailing written meeting materials to shareholders. Among other things, companies using notice-and-access must comply with new notice requirements and timelines in connection with annual shareholder meetings. The implementation of notice-and-access appears to be a first step by Canadian securities regulators toward reducing and eliminating the reliance on paper in the shareholder voting system.

Enforcement of Anti-Bribery Legislation

Although Canada has had anti-corruption legislation (*Corruption of Foreign Public Officials Act* (Canada)) in place since the late 1990s, it is only in recent years that law enforcement authorities have started to investigate and prosecute Canadian companies for violations. As a result, Canadian companies have begun to recognise the importance of establishing their own anti-corruption compliance programmes. Such policies are typically aimed at preventing the commission of an offence at the outset and include appropriate processes if potential breaches of the applicable legislation do arise.

Risk Management

Recent highly visible domestic and international risk management failures (e.g. instances of privacy breaches, regulatory (including, environmental and health and safety) non-compliance, financial fraud and resulting litigation and exposures) have thrust "Risk Management" back into the spotlight. In January 2013, the Office of the Superintendent of Financial Institutions Canada ("OSFI") released revised Corporate Governance Guidelines (the "Revised Guideline") for federally regulated financial institutions and identified risk management as a main theme and contemplates enterprise-wide risk identification and focussed management.

Corporate Social Responsibility

Today, most large companies in Canada employ personnel that are specifically dedicated to developing socially responsible corporate practices. Among other things, boards have identified the need to engage stakeholders through a variety of different means, such as through social media, and in many cases, corporations have voluntarily committed to international corporate social responsibility guidelines. Various factors including the recent economic downturn and underperformance among many listed companies has led to growing public scrutiny of corporate boards, including a renewed emphasis on the role of boards in promoting socially responsible corporate practices.

National Securities Regulator

Since the 2011 Supreme Court of Canada ("SCC") decision that the proposal to create a national securities regulator to replace the current system of provincial and territorial agencies was unconstitutional, the federal government has continued its efforts to work with the provinces toward establishing a national securities regulator under a model of cooperative federalism. However, the federal government has indicated that if an agreement with the provinces cannot be reached, it will propose legislation that is focused on those other matters of national importance that the SCC has suggested may support federal legislation, such as preventing and responding to systemic risk.

Emerging Market Issuer Review

The disclosure and corporate governance practices of emerging market issuers continues to be identified by Canadian securities regulators as an issue that requires attention. In March 2012, the Ontario Securities Commission ("OSC") released a summary of its review of the disclosure and corporate governance practices of more than 50% of the emerging markets (or venture) issuers listed on Canadian exchanges and its principal concerns relating to the level of governance and disclosure, audit function adequacy for financial statements, adequacy of due diligence in connection with securities offerings and the exchange listing approval process for emerging market issuers.

Following this review, in November 2012, the OSC provided additional guidance to emerging market issuers with OSC Staff Notice 51-720 – *Issuer Guide for Companies Operating in Emerging Markets* (the "Issuer Guide"). The Issuer Guide offers assistance and clarification to emerging market issuers and their directors and management on governance and disclosure practices, and includes disclosure guidance to assist companies and their boards in assessing risks and complying with applicable Canadian securities law.

Diversity on Corporate Boards

Many academics and industry sectors are actively commenting on the significant and positive impact a diverse board can have on business outcomes, some arguing that the use of mandatory quotas is not the most effective way to improve board diversity. In April 2013, the federal government announced the creation of an advisory council of leaders from the private and public sectors to promote the participation of women on corporate boards.

2 Shareholders

2.1 What rights and powers do shareholders have in the operation and management of the corporate entity/entities?

The operation and management of a corporation is primarily the responsibility of directors, although certain fundamental matters require shareholder approval. Corporate legislation in Canada typically requires shareholder approval of amendments to a corporation's articles or other charter documents, selling all or substantially all of the corporation's assets and the amalgamation of a corporation with one or more other corporations, among other things. For decisions that may affect the rights of holders of different classes or series of shares in different ways, separate approval of the holders of each class or series may also be required. Shareholders may also have the right to dissent in respect of certain fundamental changes and have their shares purchased for fair value, if a sufficient majority of the other shareholders have voted to approve the fundamental change.

If a director does not perform as shareholders wish, shareholders may refuse to vote to re-elect him or her. In practice, however, the power of individual shareholders to elect or remove directors in public or other widely-held companies may be limited. As noted in question 1.3, "majority voting" is gaining acceptance in Canada.

If a shareholder meets the specific requirements of the corporation's governing jurisdiction, he or she may be entitled to submit a proposal for consideration and a vote of shareholders at an annual shareholder meeting, or requisition a shareholder meeting. Depending on the requirements of the jurisdiction, a shareholder is required to hold a specific percentage of the shares of the corporation or a minimum value of equity in the corporation to be entitled to submit a proposal or requisition a meeting, and would typically be required to hold voting shares in the corporation. In a number of instances, corporations may refuse to accept a proposal, such as where it is clear that the proposal does not relate in a significant way to the business or affairs of the corporation, or refuse to call a meeting, such as where notice of a shareholder meeting has already been given or the subject matter of the requisition is inappropriate.

In some Canadian jurisdictions, shareholders can enter into a unanimous shareholder agreement that restricts or transfers directors' usual powers of management and supervision. For obvious reasons, this arrangement is typically limited to private, closely-held corporations.

Securities laws or stock exchange rules also provide additional shareholder rights. Corporations listed on the TSX, for example, may be required to obtain the approval of shareholders for the issuance of shares in certain circumstances where shareholder approval would not otherwise be required under corporate law.

2.2 What responsibilities, if any, do shareholders have as regards the corporate governance of their corporate entity/entities?

As a general rule, shareholders do not have responsibilities for the corporate governance of a corporation. However, and as is noted in more detail in question 2.7, shareholders that hold a significant percentage of the shares of a public company, that have some degree of control over the affairs of the corporation or that have a significant business or other "special relationship" with the corporation may have certain responsibilities under securities legislation. Additionally, for corporations governed by a unanimous shareholders' agreement, the shareholders would be responsible for the governance of the corporation to the extent outlined in that agreement.

2.3 What shareholder meetings are commonly held and what rights do shareholders have as regards them?

Annual meetings of shareholders, including the election of directors and the appointment of auditors, are required by law. Directors may also call a special meeting at any time and shareholders may have rights to requisition a meeting as described in question 2.1.

Directors must provide notice to shareholders of each meeting. Public companies and certain widely-held private corporations must also send a management proxy circular, and certain shareholders may be entitled to submit proposals to be included in that material. Given the notice requirements in corporate and securities laws, the ability of a corporation to deal with matters put forward at a meeting for consideration by shareholders that were not outlined in the notice of meeting is very limited.

2.4 Can shareholders be liable for acts or omissions of the corporate entity/entities?

A corporation is considered to be a separate legal entity from its shareholders. In general, shareholders have limited liability for any act, liability, obligation or default of the corporation. However, liability may be imposed on shareholders in instances of an improper decrease in the capital of the corporation, in respect of a unanimous shareholder agreement that restricts the powers of directors to manage the business and affairs of the corporation, and on the dissolution of the corporation. Moreover, courts may impose liability on shareholders in exceptional circumstances, such as fraud.

2.5 Can shareholders be disenfranchised?

Shareholders can only be disenfranchised in very limited circumstances, as any decision that would affect or remove the rights of a class or series to vote would typically require the approval of a significant majority of the holders of shares of that class or series.

2.6 Can shareholders seek enforcement action against members of the management body?

Shareholders have access to a number of mechanisms to take enforcement action against management. Shareholders may request the court to order an investigation into the corporation, and in certain circumstances, may also apply to the court for the liquidation or dissolution of a corporation. A shareholder may also apply to the court for an order requiring a corporation or its directors or officers to comply with, or refrain from breaching, the requirements of the governing corporate statute and regulations, the corporation's articles or by-laws, or a unanimous shareholder agreement.

Shareholders (both current and former) may apply to the court for an oppression remedy where there has been oppressive or unfairly prejudicial conduct, or conduct that unfairly disregards their interests. The court has broad discretion as to the terms of any order, including the discretion to award damages or order the acquisition of a shareholder's shares by the corporation.

If the directors of a corporation do not diligently pursue a cause of action of the corporation after receiving reasonable notice from the shareholder, the shareholder may be entitled to commence a derivative action against the directors on behalf of the corporation, as long as the shareholder is acting in good faith and in the best interests of the corporation.

2.7 Are there any limitations on, and disclosures required, in relation to interests in securities held by shareholders in the corporate entity/entities?

A shareholder who acquires ten per cent or more of the issued voting or equity securities of any class of a public company must issue a press release disclosing its identity and the extent of its holding. The same requirement applies each time the shareholder acquires an additional two per cent or more.

A person or corporate entity that has ownership of, or control over, securities of an issuer carrying more than ten per cent of the voting rights of the issuer's outstanding voting securities is considered an "insider" of the corporation under securities laws, and must file insider reports with securities regulators when that interest or control is acquired and within five days of any subsequent change.

A shareholder with more than twenty per cent of the voting rights attached to all outstanding voting securities of an issuer is considered a "control person", and must comply with certain requirements when disposing of, or acquiring more, shares.

3 Management Body and Management

3.1 Who manages the corporate entity/entities and how?

A corporation is managed by a board of directors. The board of directors is generally required to manage, or supervise the management of, the business and affairs of the corporation, subject to any unanimous shareholder agreement. There are also specific duties imposed on directors, including issuing periodic shareholder reports, declaring dividends, reviewing financial statements, setting remuneration for senior management, and approving the issuance of shares.

In general, directors are not actively involved in the day-to-day business and activities of the corporation. Delegation to senior officers and other management and board committees for public companies and large corporations is common practice. All public companies are required to have at least an audit committee. Notwithstanding any delegation, except for any transfer to shareholders by unanimous shareholder agreement, where permitted, directors still remain responsible for the supervision of the management of the corporation.

A private corporation must have at least one director, while a public company must have at least three. The requirements for Canadian residency of directors vary across Canada, and although there are several jurisdictions where there are no residency requirements (including British Columbia), a number of jurisdictions require that at least twenty-five per cent of the directors are resident in Canada.

3.2 How are members of the management body appointed and removed?

In general, qualified directors are elected by the shareholders of the corporation at the annual general meeting, with some potential for overholding. In some instances, the governing corporate legislation or the charter documents of the corporation may provide that, between annual meetings, the current directors can appoint additional directors up to a certain percentage of the current size of the board (typically one third). Directors commonly serve for one-year terms, although the shareholders may elect directors for terms of up to three years (subject to term limit requirements in applicable securities laws). There is no statutory limit on the number of terms that a director may serve. Directors can be removed from office during their term by the corporation's shareholders. A majority of the shareholders must vote for a director's removal at a special meeting. Such a meeting may be called by the directors at any time.

3.3 What are the main legislative, regulatory and other sources impacting on contracts and remuneration of members of the management body?

Corporate statutes contain provisions relating to contracts with, and the remuneration of, directors. In general, directors of the corporation are responsible for determining the remuneration of the directors (typically an annual retainer, plus meeting fees), as well as parameters for the officers and employees, although in most public companies, remuneration is set by the compensation committee of the board of directors, in consultation with senior management. The charter documents or any unanimous shareholder agreement may limit this power.

Public companies must disclose annually the rationale for and amount of remuneration provided to their directors and senior executive officers, in accordance with the requirements of securities laws.

The TSX requires that a listed corporation receive approval from the majority of its directors and security holders before providing certain security based compensation arrangements to its directors and officers, including stock option plans and stock appreciation rights.

3.4 What are the limitations on, and what disclosure is required in relation to, interests in securities held by members of the management body in the corporate entity/entities?

Directors are permitted to own securities in the corporation on whose board they serve. However, as "insiders" of the corporation, directors are required to file insider reports related to their ownership of securities and related financial instruments and are subject to insider trading rules, which prohibit the director from trading in the securities of the corporation when in possession of confidential information which, if generally known, would reasonably be expected to have a significant effect on the market price or value of a security of the corporation.

3.5 What is the process for meetings of members of the management body?

A corporation has some freedom in determining the process for its meetings, subject to any applicable corporate law requiring meetings to be held in Canada. The corporation typically sets out in its by-laws the location and notice requirements for such meetings, as well as the quorum required at the meeting. For jurisdictions with Canadian residency requirements for membership on the board of directors, similar residency requirements may also apply to attendance at meetings.

Directors must attend meetings personally. Proxies or representatives are not permitted. However, attendance at meetings may be accomplished by telephone or other electronic means so long as all participants are able to communicate adequately with each other.

Minutes of directors' meetings must be taken and kept, along with any resolutions, in the corporation's records.

3.6 What are the principal general legal duties and liabilities of members of the management body?

Directors have a duty to comply with the governing corporate statute and regulations, relevant securities and stock exchange rules, industry or activity regulation, employment-related, environmental and taxation regulation, the common law, the charter documents of the corporation and any unanimous shareholder agreement.

Two overarching duties generally imposed on directors are that they act honestly and in good faith, with a view to the best interests of the corporation, and that they exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. Directors may be held personally liable for breaching these duties.

3.7 What are the main specific corporate governance responsibilities/functions of members of the management body?

Directors generally formalise the corporation's approach to corporate governance. Securities legislation and best practices recommend that the directors of a public company adopt written mandates explicitly acknowledging responsibility for the stewardship of the company and setting out specific responsibilities and proper processes to facilitate oversight and promote engagement, accountability, transparency, efficiency and effectiveness. Directors must ensure that a corporation's strategic plans are being implemented, that risks and practices are being monitored, and that its business is being run effectively and responsibly.

3.8 What public disclosures concerning management body practices are required?

Most public companies are required to include information about their audit committees in their annual information form. They are also required to disclose the review and approval process adopted by the directors and relevant committees when seeking shareholder approval for certain transactions, such as a related party transaction.

A public company, other than a venture issuer, must also disclose certain information when soliciting a proxy from a security holder for the purpose of electing directors, including: the identity and independence of the directors, including the chair; the attendance record of the directors; the nature of board meetings; the board mandate; the existence of written position descriptions for the chair, the CEO and the committee chairs and/or their roles; orientation and continuing education for directors; the existence of a code of conduct; nomination and compensation processes for directors and officers; board committees; and board and individual director assessment.

3.9 Are indemnities, or insurance, permitted in relation to members of the management body and others?

In general, within parameters that are consistent with their personal duties and the required standard of care, Canadian companies are permitted by statute and it is common practice to indemnify and insure directors and officers, former directors and officers, and individuals who act or have acted in a capacity similar to directors or officers.

4 Transparency and Reporting

4.1 Who is responsible for disclosure and transparency?

The directors of a corporation are ultimately responsible for disclosure and transparency and set the 'tone from the top'. However, routine compliance with continuous disclosure obligations is typically overseen by the management team that is accountable to the board. Many corporations have taken steps to formalise the process of meeting their disclosure obligations. Typically, the board will adopt a disclosure policy to guide members of management on issues of disclosure. Additionally, some corporations will establish a disclosure committee in order to consider and review the corporation's disclosure and ensure that all disclosure requirements have been met fully and accurately.

4.2 What corporate governance related disclosures are required?

Canadian public companies are required to disclose their corporate governance practices in accordance with the specific guidelines issued by Canadian securities regulators in their management proxy circular and/or annual information form. The primary corporate governance disclosure requirements are outlined in detail above in question 3.8. In addition, there are also specific disclosure requirements for public companies related to the public filing of articles of incorporation or any other constating document, corporate by-laws, the code of conduct (if any) and any other documents affecting the rights of shareholders, such as a voting trust agreement or shareholders' rights plan.

4.3 What is the role of audit and auditors in such disclosures?

In Canada, there is no requirement for auditor review of a public company's corporate governance disclosure. All public companies must engage an external auditor to review their financial statements. The auditor's role is limited to conducting an audit to obtain reasonable assurance that the financial statements of the corporation are free of material misstatement and providing an opinion on the financial statements based on the audit.

4.4 What corporate governance information should be published on websites?

Canadian public companies are required to file their mandated disclosure documents on the System for Electronic Document Analysis and Retrieval ("SEDAR") website maintained by the Canadian securities regulators, at www.sedar.com. In addition, a company that uses the process of notice-and-access outlined in question 1.3 to provide shareholders with certain materials related to a shareholders' meeting is required to post the materials on both SEDAR and a non-SEDAR website (typically the company's website).

Canadian law does not generally require that public companies publish information on their websites. Nevertheless, many public companies provide access on their websites to news releases and other information filed on SEDAR as a matter of good practice. Many corporations also post on their websites the text of committee charters, webcasts of annual shareholder meetings and their code of conduct and other key policies.

5 Corporate Social Responsibility

5.1 What, if any, is the law, regulation and practice concerning corporate social responsibility?

Despite the continuing increase in public attention to, through academic, regulatory, judicial and media, and expectation for, corporate social responsibility ("CSR") practices by corporations in Canada, Canadian corporate and securities laws do not generally regulate expectations for CSR, and attempts in recent years to pass such legislation, have failed.

However, specific continuous disclosure obligations are triggered in certain circumstances where the corporation has undertaken particular initiatives. Public companies which have implemented any social or environmental sustainability policies that are fundamental to their operations, such as policies regarding the environment, those communities in which they operate, or human rights, must describe these policies, and steps taken to implement them, in their annual information form. Additionally, corporations must outline the financial and operational effects of environmental protection requirements on their current and future capital expenditures, earnings and competitive position in their annual information form and/or management discussion and analysis. Corporations that violate federal environmental legislation may be ordered by a court to disclose such violations to their shareholders.

The federal government promotes several widely-recognised, but not mandatory, international CSR performance guidelines, such as the Global Reporting Initiative. In addition, the federal government has established the Office of the Extractive Sector Corporate Social Responsibility Counsellor to perform both an advisory role, and a dispute resolution role in managing issues related to CSR in Canada's extractive sector.

5.2 What, if any, is the role of employees in corporate governance?

Employees of corporations are typically expected to comply with company policies, including a code of conduct, if one has been implemented, as well as proper processes to facilitate board and management oversight and promote engagement, accountability, transparency, efficiency and effectiveness.

Audit committees of public companies are required to establish procedures for the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters.

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