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Proposed *Canada Business Corporations Act* amendments: A new era of true majority voting and diversity?

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On September 28, 2016, the federal government introduced Bill C-25 in Parliament, proposing significant amendments to the *Canada Business Corporations Act* (CBCA) (the Proposed Amendments). If adopted, the Proposed Amendments will impose obligations on reporting issuers (and other distributing and prescribed corporations, defined in the CBCA) in line with current governance best practices, including the following:

- true majority voting: requiring shareholders to cast their votes "for" or "against" each individual director's election (rather than slate voting), and prohibiting a director who has not been elected by a majority of the votes cast from serving as a director, except in "prescribed circumstances";
- annual director elections: requiring corporations to hold annual elections for all directors of a company's board, effectively prohibiting staggered boards; and
- diversity disclosures: requiring corporations to place before shareholders, at each AGM, information respecting diversity among the directors and among the members of senior management.

True majority voting requirement

In 2014, the Toronto Stock Exchange (TSX) implemented rules requiring majority voting for most TSX-listed issuers. This entailed adopting a majority voting policy requiring any undersupported director (i.e., a nominee who does not receive a majority of "for" votes) in an uncontested director election to tender his or her resignation to the board; the board is then required to consider and, save for "exceptional circumstances," accept that resignation and publicly announce its decision. Since then, there has been some lingering controversy surrounding the TSX's majority voting standard as a result of many boards rejecting the resignations of undersupported directors in reliance on those so-called exceptional circumstances, despite the expressed will of the shareholders.

For example, our *Davies Governance Insights 2015* report revealed that in 2015 only one of 10 directors who failed to achieve majority support from shareholders had their resignation accepted by the board. The report explained how some of the boards relied on the "exceptional circumstances" carve-out to allow undersupported directors to remain on the board. Our most recent *Davies Governance Insights 2016* report, however, suggests that this trend may be changing: in 2016, in those cases where directors of issuers on the TSX/S&P Composite and SmallCap indices received less than majority approval, the boards accepted their resignations.

The Proposed Amendments would put an end to this debate. They provide that (1) the shareholders of a distributing corporation will be able to vote only "for" or "against" each *individual* director (as opposed to withholding their votes); and (2) each director is elected only if the number of "for" votes represents a majority of the total shareholder votes cast. Slate voting would no longer be permitted, except for certain "prescribed corporations" (to be outlined in revised regulations, not yet published, to the CBCA). Moreover, the Proposed Amendments also provide that a director who is not elected by a majority cannot be appointed by the remaining directors to fill a vacancy on the board, except in "prescribed circumstances."

In doing so, the Proposed Amendments would reverse the current practice that has developed under the TSX rules: rather than having an undersupported nominee elected as a matter of law and leaving to the board the decision on whether to accept their resignation, the Proposed Amendments would mean that a nominee who fails to get a majority of "for" votes is *not* elected as a matter of law, and may be appointed by the directors only in "prescribed circumstances." Whether the Proposed Amendments will result in meaningful change to the current practice for TSX-listed companies will, however, depend on what those "prescribed circumstances" are, to be set out in the not yet released regulations to the CBCA.

Annual elections now required

The TSX rules currently require its listed companies to hold annual director elections, effectively prohibiting staggered boards, a fairly uncommon practice in Canada. The Proposed Amendments will bring the CBCA up to speed with this current corporate governance best practice. We note that an exception included in the Proposed Amendments allows for elections to be held in accordance with existing CBCA requirements, which allow for three-year terms and staggered boards, in the case of "any prescribed class of distributing corporations" or "any prescribed circumstances respecting distributing corporations." There is currently no such exception in the TSX rules, save for foreign issuers. The impact of this change will, therefore, depend upon the prescribed categories of corporations and circumstances that will be proposed in the CBCA regulations, if this change is implemented.

Disclosure relating to diversity

TSX-listed and other non-venture issuers are currently required, under National Instrument 58-101 – *Disclosure of Corporate Governance Practices* (NI 58-101), to disclose certain information relating to the diversity of their board and executive officers, including whether they have adopted a written policy regarding female representation on the board, whether they consider the level of female representation when making board or executive officer nominations or appointments, and whether they have adopted a target regarding the representation of women on the board or in senior management; if not, the issuer must disclose why not. The Proposed Amendments to the CBCA would require "prescribed corporations" to provide the "prescribed information" respecting diversity among their directors and members of senior management.

Once again, the "prescribed corporations" and "prescribed information" that will need to be disclosed have not yet been determined. Accordingly, until proposed regulations clarifying these concepts have been released, it remains unclear whether the Proposed Amendments will alter the existing "comply or explain" model under NI 58-101 or impose stricter requirements on subject companies. We do not, however, expect the Proposed Amendments to impose targets or quotas on issuers; instead, they are likely to promote a similar approach to that currently in place under securities laws.

Conclusions

The majority voting requirement set forth in the Proposed Amendments is likely to bring an end to the debate over those circumstances in which an undersupported director may remain on the board. The questions, however, that are still unanswered will be whether boards will be inclined to use the Proposed Amendments to fill a vacancy by appointing an undersupported director whose failed election created the vacancy in the first place; and, in such a situation, how stringent the "prescribed circumstances" will be that would allow the directors to appoint an undersupported director. We also note there are some inconsistencies between the TSX rules and the Proposed Amendments that could subject some TSX-listed CBCA companies to potentially different (and potentially conflicting) sets of rules. We expect the regulators are attuned to and will be focused on minimizing that risk. In any case, if the Proposed Amendments are adopted, we expect TSX-listed issuers that are governed by the CBCA may need to revisit and revise their majority voting policies to ensure compliance with the Proposed Amendments.

While some view the Proposed Amendments as a welcome modernization of the federal corporate statute and a reflection of the need to enhance companies' corporate governance practices, in many ways the Proposed Amendments are entrenching practices or policies that are already addressed under the TSX rules and securities laws. By delving into these areas, there remains a risk that the Proposed Amendments could lead to compliance and interpretational issues, as well as confusion over the appropriate mandates for each of the regulators, a concern expressed by some commentators in response to Industry Canada's initial December 2013 consultation paper on the potential CBCA amendments. In addition, several undetermined exceptions and terms that will be laid out in revised CBCA regulations have yet to be published – only once they are will the full impact of the Proposed Amendments be known.

You can read more about majority voting, initiatives designed to improve corporate leadership diversity and the other top trends and issues in corporate governance in Canada in our recently released *Davies Governance Insights 2016*.