Commentary: Rebuilding Our Commercial Law Infrastructure to Keep Ontario Competitive in Global Markets

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With increasing globalization, it is no longer enough for our legislators to assess their commercial law infrastructure in terms of sister provinces. Rather, Ontario's legal infrastructure is now being assessed in terms of those prevailing in world financial centres, primarily, New York, London and Frankfurt.

Ontario is blessed with some natural competitive advantages. These include its stable political and economic environment, its governance by the rule of law, its sound financial institutions, an educated workforce, its linguistic and multi-ethnic diversity and a strong commercial law bench and bar.

Unfortunately, if we look closely at the state of our commercial laws, it appears that Ontario may be losing ground to other major financial centres. The question is whether our elected representatives in Ontario are doing all that they can to maintain Ontario as a globally competitive financial and commercial jurisdiction.

The most obvious deficiency in our current commercial law is the absence of a uniform statute, governing the transfer and pledge of investment securities. Such a law forms a crucial underpinning for our otherwise-sophisticated securities settlement system, which handles daily transactions averaging around CAN$100 - $150 billion.

We currently have a patchwork of inconsistent and incomplete rules contained in numerous federal and provincial corporate statutes. These rules fail to address the securities of non-corporate issuers such as governments, crown agencies, limited partnerships, real estate investment trusts and income trusts. They make transactions unnecessarily difficult and expensive, generally reducing efficiency and competitiveness.

In contrast, the United States has had uniform securities transfer laws for over 50 years, and its 1994 revisions (adopted uniformly by all 50 states) make it the most advanced law in the world of its type. In light of the obvious advantages for Canada to have similar uniform laws and the availability of a comprehensive proposal to provide such laws almost immediately, this is a commercial-law subject that should command more attention and support from government - especially Ontario.

There are other deficiencies too.

In 2001, the federal government enacted a wholesale reform of the *Canada Business Corporations Act*. As a result, the CBCA leaped ahead of the equivalent Ontario statute in several key areas. These include residency requirements for directors, financial assistance, indemnification of directors and officers, shareholder proposals and unanimous shareholder agreements. Ontario, for example, is one of the last remaining jurisdictions in the country that still generally requires that a majority of board members be resident Canadians. Other provinces have removed this requirement including, most recently, British Columbia, in its new statute.

Currently, the only jurisdiction that permits the formation of unlimited companies is Nova Scotia. Unlimited companies provide U.S. investors with favourable U.S. tax treatment and have become the vehicle of choice for large-dollar direct U.S. investment into Canada. There is no loss of Canadian tax revenue from allowing the formation of unlimited companies.

As a result of its monopoly, Nova Scotia has implemented a series of fee increases so that, today, there is a $4,000 tax on an incorporation (20 times the fee for an electronic incorporation under the CBCA) and a $2,000 tax for an annual return (more than 100 times the fee charged for an electronic filing under the CBCA). There is no reason why Ontario could not offer U.S. investors an Ontario unlimited company so as to simplify their life and signal that Ontario is open for business.

Ontario is one of the last jurisdictions in Canada to keep bulk sales laws on its books. The only other holdout is Newfoundland and Labrador. Bulk sales laws increase the compliance costs of completing business acquisitions through asset purchases. It is turn of the 20th century legislation that, in Ontario, has made it into the 21st century.

In recent years, investors have made increased use of non-corporate or alternative business vehicles primarily for tax reasons. Alternative business vehicles include partnerships, limited partnerships, joint ventures, unlimited companies, real estate investment trusts, resource royalty trusts and income trusts. The law governing partnerships and limited partnerships has been fundamentally unchanged since the 1890s. Hence, partnerships are still not generally recognized as legal entities. Much uncertainty surrounds the extent to which limited partners can change a general partner or otherwise influence the direction of the firm without loss of their limited liability shield.

The situation confronting business trusts is even worse. In contrast to the U.S, Ontario still has not resolved many fundamental legal issues concerning the now popular business trust as an investment vehicle. These issues include beneficiary liability, the liability of trustees to creditors, the right of trustees to indemnification out of trust assets and the rights of unsecured creditors to look directly to the assets of a trust. Furthermore, it is ironic that, as rules concerning corporate governance have become tougher in the wake of the *Sarbanes-Oxley Act*, nothing has been done to replicate the laws on corporate governance for alternative business vehicles such as the business trust. Comprehensive legislation governing business trusts only exists south of the boarder.

For many years, Ontario has gone its own way with respect to its *Personal Property Security Act*, the principal statute governing the creation, registration and enforcement of security interests in personal property. One fundamental difference between Ontario and the remaining Canadian common law jurisdictions is the characterization of equipment leases as secured transactions. Outside Ontario, the remaining common law jurisdictions provide that, where an equipment lease is for a term of more than one year, it creates a security interest and is governed by the same legislation that governs other security interests. In Ontario, there is no such clear rule. The result of this disharmony was recently demonstrated in an Ontario Court of Appeal decision, *TCT Logistics*, where an equipment lessor registered in Ontario but not in the relevant province and then had to argue that the equipment lease should be dealt with under Ontario law as a true lease. Had Ontario harmonized its laws with the remaining provinces, the case would never have come to court.

One aspect of the new Ontario *Limitations Act*, which came into force on January 1, 2004, has reduced Ontario's attractiveness as a commercial and business centre. While many of the features of the new law are salutary, it contains a controversial provision stating that a "limitation period under [the] Act applies despite any agreement to vary or exclude it". This provision creates unnecessary confusion in both commercial and consumer transactions. The result has been an exodus of some commercial transactions from Ontario so that, where possible, the contracting parties can contract as they please and avoid the uncertainty that the new Ontario legislation casts on their private agreements.

It is easy to overlook the significance of commercial laws, but they are crucial to our financial and commercial infrastructure. They are important not only to Ontarians but also to all Canadians. For better or worse, Ontario will remain the leading financial and commercial jurisdiction within the country and the principal entry point for foreign investment and trade.

Our legislators should be doing everything they can to keep Ontario competitive by international standards. They should certainly not let Ontario's commercial law infrastructure fall into the sad state of disrepair that has become evident.

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