

CORPORATE BULLETIN

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BILL 152, PENDING CHANGES TO THE OBCA AND THE PARTNERSHIPS ACT

Clients should be aware that Bill 152, which received Royal Assent on December 20, 2006, and which will come into force on August 1, 2007, will make significant changes to the *Business Corporations Act* ("OBCA") as well as an important change to the limited liability shield for limited liability partnerships ("LLPs") under the *Partnerships Act* (Ontario). What follows summarizes the highlights.

1. Reducing the Board Residency Requirement

Bill 152 will reduce the usual residency requirement for directors of an OBCA corporation from a majority (51%) to 25% of the directors. This conforms to the board residency threshold under the *Canada Business Corporations Act* ("CBCA") and recent changes made to the general corporate statutes of Alberta, Saskatchewan and Manitoba. It appears that the Ontario government was concerned that elimination of the residency requirement entirely would make it more difficult to enforce provincial tax statutes against corporations conducting business in Ontario if those corporations opt for boards without resident Canadian directors. Foreign investors and others who wish to avoid any Canadian residency requirement will, therefore, have to opt for incorporation, or continuance, under the corporate laws of British Columbia, New Brunswick, Nova Scotia or any of the territories. The by-laws of an OBCA corporation may require amendment if they have hard-wired the existing majority residency requirement. The OBCA amendments will not override existing by-laws.

2. Eliminating the Canadian Residency Requirement at Board and Committee Meetings

However, unlike the CBCA, the OBCA will no longer require that there be any minimum level of resident Canadians at a board meeting. Likewise, the OBCA will not require any resident Canadians on any board committees. Nor will the managing director of an OBCA corporation still have to be a resident Canadian. However, again, existing by-laws may have to be revisited to take advantage of the increased flexibility that Bill 152 will bring.

3. Repealing the Financial Assistance Provisions

The OBCA was amended in 2000 to considerably emasculate the much-maligned financial assistance provision, s. 20. The OBCA adopted a variant of Saskatchewan model post-transaction disclosure regime, replacing the former double solvency tests. In 2001, the CBCA went one step further by entirely abolishing s. 44, the federal financial assistance provision. Bill 152 will follow the federal lead and eliminate the provision. Thus, the OBCA will no longer have a specific provision requiring disclosure to the corporation's shareholders of related-party or share-purchase financial assistance.¹

4. Facilitating Corporate Finance

Bill 152 will make several useful amendments to Part III of the OBCA, which deals primarily with share capital. For example:

- (a) the OBCA will be clarified so that separate classes of shares can exist without necessitating differences in their respective rights, privileges, restrictions and conditions. No longer will it be necessary to invent artificial distinctions between share classes to ensure that they will be legally recognized as separate classes;

¹ The regulations to the OBCA have been redrafted in light of Bill 152. However, Ontario Regulation 59/07 does not explicitly require disclosure of financial assistance in management information circulars.

- (b) like the CBCA, the OBCA will enable a corporation to add to its stated capital account less than the full consideration received for shares issued in exchange for property (whether from arm's length or non-arm's length purchasers). This facilitates rollover transactions involving arm's length parties. The OBCA contains a minor improvement on the corresponding CBCA regime in that the consent of existing shareholders of the class to an issuance of shares in exchange for property to an arm's length purchaser is only needed where the issuance would result in a dilution of the mean stated capital per share (exposing existing shareholders to a potential tax increase on a future deemed dividend);
- (c) the prohibition against subsidiary ownership of shares of an OBCA corporation will be lifted in circumstances to be set out in the revised regulations to the OBCA;² and
- (d) the OBCA will be amended to eliminate any residual uncertainty over whether the declared amount to be added to the stated capital account on the declaration of stock dividends must equal the fair market value of the shares issued on declaration of the stock dividend or can be some lesser amount. This will remove any uncertainty over whether "high-low" stock dividends are permitted.

5. Reducing the Ambit of the Duty of Care Owed by Directors and Officers

In *Peoples Department Stores Inc. (Trustee of) v. Wise*,³ the Supreme Court of Canada held that a director (and, *ergo*, an officer) of a CBCA corporation owes his or her statutory duty of care not only to the corporation but also to other stakeholders, including, specifically, creditors. This interpretation came as a surprise to many in the corporate and legal communities. Bill 152 amends the OBCA to clarify that the statutory duty of care, like the fiduciary duty, is owed exclusively to the corporation.

6. Revamping the Conflict of Interest Rules

In 2001, the CBCA upgraded the conflict of interest regime imposed on directors and officers of CBCA corporations. By virtue of Bill 152, the OBCA will now adopt a number of these changes, including the following:

- (a) a general notice of interest will be effective until there has been a change in the nature of the director's or officer's interest in the other entity;
- (b) a conflicted director is barred not only from voting to approve the material contract or transaction in which he or she is interested but also from participating in the meeting at which the contract or transaction is discussed; and
- (c) the ambiguous and badly-conceived provision entitling a conflicted director to vote on an arrangement by way of security for money lent to or obligations undertaken by the director for the benefit of the corporation or an affiliate will be repealed.

7. Improving the D&O Indemnification and Insurance Regime

The 2001 amendments to the CBCA dramatically improved the director and officer indemnification and insurance provisions of that Act. Through Bill 152, the OBCA regime will be enhanced as follows:

- (a) as in the case of the CBCA, indemnification will cover all individuals acting as a director or officer of the corporation or acting, at the corporation's request, as a director or officer for another body corporate (or acting in an equivalent role for an entity other than the indemnifying corporation). Thus, indemnification applies to those acting on behalf of non-corporate entities such as partnerships, trusts, joint ventures, limited liability companies or unincorporated organizations;
- (b) there will no longer be a requirement that the indemnifying corporation have any financial interest (whether consisting of shares in or loans to) the entity on whose board or equivalent body the corporation's nominee sits. Rather, who may be indemnified is left to the business judgment of the directors of the indemnifying corporation limited, of course, to their general fiduciary duties and duty of care;

² Under ss. 25.1, 25.2 and 25.3 of draft regulation OR 59/07, an offering corporation is permitted to temporarily issue shares to a wholly-owned subsidiary to facilitate certain cross-border share-for-share acquisitions of foreign targets.

³ [2004] 3 S.C.R. 461.

- (c) permitted indemnification will be extended beyond civil, criminal and administrative proceedings to include investigative or other proceedings, which have grown in significance in the corporate sphere. These would include, for example, an investigation by a securities commission, an investigation under the OBCA or an investigation made prior to or in anticipation of laying a criminal charge;
- (d) perhaps, most importantly, the OBCA now expressly includes a provision allowing the corporation to advance monies to a director, officer or other individual for defence costs. Directors and officers are usually less concerned about an ultimate finding of liability than with the often astronomical cost of defending the claim;
- (e) an OBCA corporation will also be permitted, with court approval, to advance monies to a director or officer in a derivative action;
- (f) a director or officer of an OBCA corporation will be entitled to indemnification if a court or other competent authority has not judged that he or she committed any fault or omitted to do anything that he or she ought to have done. This will replace the current OBCA language that forces directors and officers to go to trial for vindication and, if successful, indemnification. Consistent with policies designed to discourage litigation and the public expenditure thereby entailed, the new language introduced by Bill 152 will encourage early settlement so that the individual claiming mandatory indemnification avoids the risk of an adverse finding of fault;
- (g) like the CBCA, the OBCA will be clarified to state that indemnification will be disallowed where the director or officer has failed to comply with his or her fiduciary duties to the body corporate or other entity on whose board he or she sits (not fiduciary duties owed to the indemnifying corporation);
- (h) like the CBCA, the OBCA will now leave it to the insurance marketplace to regulate the scope of permitted coverage; and
- (i) an OBCA corporation will now be expressly permitted to purchase insurance for nominees who act on behalf of non-corporate entities.

OBCA corporations may want to revisit indemnification agreements and indemnification provisions of by-laws in light of the increased ambit of protection afforded directors and officers once Bill 152 becomes law.

8. Expanding the Due Diligence Defence

Like the equivalent provisions of the CBCA, the OBCA will now embody a due diligence defence that extends to liability of directors under s. 130 (the issuance of shares at an undervalue and improper declarations of dividends, *etc.*), s. 131 (unpaid employee remuneration and expenses) and s. 134(2) (duty to comply with the Act and, the corporation's constating documents, including any unanimous shareholder agreement). The good faith reliance defence will be retained as an aspect of exercising the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. Furthermore, as a result of Bill 152, good faith reliance can be placed, *inter alia*, on:

- (a) interim and other financial reports of the corporation (rather than just annual financial statements); and
- (b) the report or advice of an officer or employee of the corporation, where such reliance is reasonable in the circumstances.⁴

9. Updating the Voting Regime

Bill 152 will replace the old procedure whereby a transferee of shares after a record date may nevertheless establish his or her ownership of shares before the meeting and thereby become entitled to vote at the meeting. In its place, the OBCA will adopt the CBCA regime governing the voting of shares transferred between the time of the record date establishing the right to vote at the meeting and the time of the shareholders' meeting. The OBCA shareholder voting entitlement regime will now conform to National Instrument 54-101 (*Communication with Beneficial Owners of Securities of a Reporting Issuer*), thereby minimizing, if not eliminating, the problem of double-voting.

⁴ Again, this reverses that part of the Supreme Court of Canada decision in *Peoples* interpreting the equivalent CBCA provision as inapplicable to subordinate officers and employees not having a recognized "professional" designation.

10. Expanding the Exemptions from Proxy Solicitation Rules

To further promote shareholder democracy, Bill 152 has adopted the 2001 amendments CBCA, which improved the proxy solicitation regime by including exemptions for targeted solicitations to less than 16 shareholders and solicitations by public broadcast.

11. Circulating Financial Statements and Interim Financial Statements

Bill 152 will usefully reverse the default rule for circulation of financial statements and interim financial statements of offering corporations. Currently, an offering corporation is required to circulate all such financial information unless the shareholder expressly waives the right to receive it. As a result of Bill 152, an offering corporation will only be required to circulate such information to shareholders who expressly inform the corporation that they wish to receive it. In the case of non-offering corporation, the old default rule (circulation unless waived in writing by the shareholder) continues to apply.

12. Striking a New Balance Between the Competing Interests at Play in Shareholder Proposals

As a result of Bill 152, the OBCA will adopt several of the 2001 CBCA innovations designed to strike an appropriate balance between the competing interests involved in shareholder proposals, which have become the primary mechanism for expressing shareholder voice in the affairs of offering corporations. Some of these innovations are as follows:

- (a) a beneficial owner (*i.e.* an entitlement holder) will be able to initiate a shareholder proposal without first having the securities registered in his or her name;
- (b) like the CBCA, the regulations to the OBCA will impose an overall word-count that encompasses both the proposal and the supporting statement; and
- (c) the regulations to the OBCA will set minimum levels of support and time-frames for the resubmission of similar proposals – to prevent a device aimed at encouraging shareholder-management dialogue from developing into a weapon for shareholder harassment of management.

13. Expanding the Reach of Electronic Communications

The OBCA will now incorporate the *Electronic Commerce Act, 2000* (Ontario) by reference into the OBCA, thereby making electronic communications part of the organic law of the corporation and rendering the local law where the shareholder resides immaterial.

14. Relaxing the Preconditions for Bringing a Derivative Action

The only change being made to Part XVII of the OBCA (dealing with remedies) is with respect to one of the preconditions to seeking leave to bring a derivative action. Where all of the directors of the corporation or its subsidiaries are defendants in the action, there will no longer be a need to give the corporation and its directors 14 days advance notice of the complainant's intention to seek leave.

15. Replacing the LLP Liability Regime

Currently, the *Partnerships Act* (Ontario) only provides a partial liability shield to partners of an LLP. The Act only protects a non-negligent partner from personal liability for the negligent acts or omissions committed by others in the firm who are not under his or her supervision. Bill 152 will introduce a full-shield liability regime into Ontario law. Thus, subject to certain exceptions, a partner in an LLP will not be liable, by means of indemnification, contribution or otherwise, for any debts or obligations incurred by an LLP, including debts, liabilities and obligations arising from the negligent or wrongful acts or omissions of another partner or an employee. The only exceptions will be where:

- (a) the negligent or wrongful act or omission was criminal or constituted fraud; or
- (b) the partner knew or ought to have known of the act or omission and did not take the actions that a reasonable person would have taken to prevent it.

Finally, a partner will not be exempt from liability for his or her own negligent or wrongful act or omission or the negligent or wrongful act or omission of a person under that partner's direct supervision – the current liability exception.

16. Failing to Introduce Ontario ULCs

Bill 152 did not make two major changes the Ontario Bar Association sought: elimination of the board residency requirement discussed at Part 1 above and the creation of unlimited liability corporations (“ULCs”). Thus, clients still must go to other provinces if a ULC is required or the foreign investor wants a board without any resident Canadian representation. In the case of a ULC, the investor can choose to incorporate in Nova Scotia or Alberta or, soon, British Columbia.⁵ Ontario still has no ULC option.

Despite these two omissions, Bill 152 makes many otherwise useful changes to the OBCA that OBCA corporations and their directors, officers and shareholders should welcome. In some cases, corporations incorporated under the CBCA or the laws of another province may wish to consider whether the advantages that the OBCA will offer justify the costs (including exposure to the exercise of dissent and appraisal rights) of a continuance to the OBCA.

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⁵ See S.B.C., c. 13, 2007, introduced into the British Columbia Legislative Assembly on March 12, 2007.

The foregoing provides only an overview. Readers are cautioned against making any decisions based on this material alone. Rather, a qualified lawyer should be consulted.

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