

CORPORATE BULLETIN

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BILL 41, THE ALMOST FORGOTTEN CORPORATE LAW AMENDMENTS THAT WENT INTO EFFECT IN JANUARY 2007

Bill 41, which went into effect on January 1, 2007, has been widely heralded as the vehicle which finally brought to Ontario the *Securities Transfer Act, 2006* (the "STA") and made consequential amendments to the *Personal Property Security Act* (the "PPSA"). Overshadowed by these significant legislative milestones, however, have been important, albeit less significant changes to the *Business Corporations Act* (the "OBCA") and the *Execution Act* (Ontario). The purpose of this short article is to highlight these often over-looked changes.

1. OBCA CHANGES

(a) Part VI - Corporate Securities

As a result of the passage of the STA, much of Part VI of the OBCA has been repealed, resurfacing, in modified form, in the STA. Part VI of the OBCA, re-titled "Corporate Securities", is now confined to OBCA corporations, no longer to other types of issuers. Part VI now deals largely with the issuance and content of share certificates and the rights of executors, administrators, trustees in bankruptcy and the like to exercise the rights of registered security holders.

(b) Dematerialization

Before January 1, 2007, an OBCA corporation was required, upon request, to issue a securities certificate in respect of any securities that it issues or, in the alternative, a non-transferable written acknowledgement of the security holder's right to obtain a security certificate. New York and most other U.S. jurisdictions, however, have long recognized that, in the electronic age, paper certificates have become obsolete. As most corporate practitioners have experienced at some time in their careers, paper share certificates are problematic because they must be reproduced, handled and stored. They may be lost, stolen or mutilated. If a security certificate is lost or stolen, it may be exceedingly expensive for the security holder to have it replaced. An indemnity bond must generally be posted.

Under s. 54 of the OBCA, corporations are now given the option to dematerialize their securities. Dematerialization means that a corporation can dispense entirely with issuing security certificates, relying, in the case of offering corporations, completely on book-based entries maintained electronically by the corporation's register and transfer agent and, in the case of non-offering corporations, a ledger or register in paper form maintained by a lawyer.

While it is too early to predict how this new-found freedom will be used, OBCA corporations and their counsel should give serious consideration to dematerializing share certificates in the following circumstances:

- (i) whenever a corporation's shares are publicly traded;
- (ii) when the corporation's shares are not publicly traded but there are numerous shareholders and, therefore, correspondingly greater chances that share certificates will be lost or destroyed;
- (iii) when there is a risk that possession of a share certificate in the hands of disgruntled minority shareholders (such as a dismissed former employee) will be withheld in the hopes of negotiating a cancellation premium; or
- (iv) when there are only one or a few shareholders and issuing share certificates is considered to be superfluous.

In addition, the elimination of share certificates will facilitate electronic closings where, formerly, share certificates were one of the only documents that could not be transmitted electronically.

- (c) Unanimous Shareholder Agreements (“USA”)

Bill 41 made a number of innovations in the USA regime set out in the OBCA, including the following:

- (i) the OBCA now addresses the consequences if shares in a corporation, subject to a USA, are transferred to a good faith purchaser without notice of the USA. In addition, the OBCA now addresses the consequences where a corporation subject to a USA issues shares to a new subscriber who has no notice of the USA. The OBCA provides that the innocent transferee of shares subject to a USA may elect rescission or demand that the transferor pay the transferee the fair value of the shares held by the transferee. Similarly, instead of becoming bound by an undisclosed USA, an innocent subscriber of shares subject to a USA may elect, within 60 days, to rescind the contract under which he acquired the shares; and
- (ii) a lien provision (a lien on a share registered in the name of a shareholder for a debt of that shareholder to a corporation) may now be set out in a USA (as well as in the articles or by-laws).

2. EXECUTION ACT CHANGES

Sections 14, 15 and 16 of the *Execution Act* (Ontario) have been recast to facilitate seizure of securities and security entitlements in light of the STA. This new execution regime may be summarized as follows:

- (a) a sheriff may seize the interest of an execution debtor in a security or security entitlement in accordance with the STA;
- (b) if the seizure is by notice to an issuer or securities intermediary, the seizure becomes effective when the issuer or securities intermediary has had a reasonable opportunity to act on the seizure, having regard to the time and manner of receipt of the notice;
- (c) every seizure and sale made by a sheriff includes all dividends, distributions, interests and other rights to payment in respect of the security or security entitlement;
- (d) a sheriff has a power under the STA to dispose of the seized property in the place and stead of the execution debtor; and
- (e) in the case of a seized security the transfer of which is restricted by the terms of the security (such as a restriction on transfer contained in the articles of an OBCA corporation or CBCA corporation), the *Execution Act* seeks to strike a fair balance between the rights of the execution creditor to a workable remedy and the interests of the remaining shareholders in having some say over who may become their economic partners. Thus:
 - (i) the sheriff is bound by the restrictions on transfer imposed by the issuer or set out in a USA that is governed by the law of Ontario.¹ If, however, the USA is governed by the law of another province or territory, the *Execution Act* does not state that the sheriff is bound by the restriction;
 - (ii) the sheriff would be entitled to acquire or redeem the seized security for any pre-determined price or price fixed by reference to a pre-determined formula (if one applies);²
 - (iii) a sheriff, or any interested person, can seek the assistance of the court where a restriction on transfer or a person’s entitlement to acquire or redeem the seized security is made with intent to defeat, hinder, delay or defraud creditors or others. In addition, a sheriff, but not another interested person, may invoke the statutory oppression remedy;³

¹ This would for example apply to the USA of a CBCA corporation if Ontario law governs the USA.

² Such as a redemption price or retraction price specified in the articles.

³ An interested person other than the sheriff, a security holder, a director or officer would still be able to invoke the oppression remedy if such interested person satisfies the court that it is a “proper person” to seek an oppression remedy. A sheriff joins the list of “*per se*” complainants.

- (iv) unless otherwise ordered by a court, a person who acquires or takes a seized security from the sheriff shall be deemed to be a party to any USA regarding the management of the business and affairs of the issuer or the exercise of voting rights attached to the seized security; and
- (v) despite (iv) and notwithstanding any provision in the USA to the contrary, a person who acquires or takes a seized security from a sheriff is not liable to make any financial contribution to the corporation or provide any guarantee or indemnity of the corporation's debts or obligations. Thus, a creditor may realize on a security, and the purchaser of the security may acquire it, free of any concern that, in so doing, she may become liable for post-acquisition financial contributions to the corporation that may be contained in, for example, a USA.

Whether these amendments to the *Execution Act* will, in practice, result in a higher incidence of realization of securities and security entitlements by judgment creditors remains to be seen. The modifications made to the *Execution Act*, however laudatory, will not overcome the greatest obstacles facing judgment creditors in realizing on securities and security entitlements.

In the case of highly-liquid securities and security entitlements, the fundamental problem remains that it takes time for the creditor to commence an action, obtain judgment, ascertain what securities or securities entitlements the debtor has and arrange for a sheriff to enforce judgment against securities or security entitlements under the *Execution Act*. Meanwhile, it takes very little time for the judgment debtor to dispose of the underlying investment.

In the case of illiquid securities such as shares in non-offering corporations, a judgment creditor will still have difficulty obtaining salient information in order to properly evaluate the worth of the underlying securities. For example, a judgment creditor would need to know what proportion of shares the judgment debtor holds, the earnings track record, shareholder's equity and other financial details of the underlying corporation. The judgment creditor has no rights to obtain financial information from the corporation itself. The creditor must still obtain such information through an examination of the judgment debtor in aid of execution.

Even if a judgment creditor seizes the shares, those in control of the corporation may well be hostile to the judgment creditor. It is easy to foresee clashes between management in control of a private corporation and judgment creditors of a minority shareholder. For example, the imposition of a judgment creditor may influence whether management chooses to remunerate itself by way of salary and bonus or by way of dividend.

So, while lenders and securities intermediaries may have begun the process of implementing changes in light of the STA and the PPSA amendments, many other clients (particularly OBCA corporations and unsecured creditors looking to recover judgment debts) should consider the changes that Bill 41 made to the OBCA and the *Execution Act*. For some, these ancillary changes to the OBCA and *Execution Act* may carry more significance than statutory recognition of the indirect or tiered holding system.

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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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