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**CPA Governance: Rules of Navigation**

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**Presented at the ACPA Governance Seminar**

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# CPA Governance: Rules of Navigation



Presentation by Bill Hearn  
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# Introduction

*“In recent months, investors in both North America and Europe have shown a growing interest in corporate governance issues. As well, it has become apparent that there is a direct relationship between corporate governance and investor confidence in capital markets”*

Sound familiar?

## Introduction

- Pearce Bunting, then President of the Toronto Stock Exchange made this statement in April 1993 when the TSX first established its Committee on Corporate Governance

## Introduction

- For past decade, much has been written on corporate governance
- Assumes that good boards make good companies
- But a good board does not guarantee anything
- And a bad board does not necessarily a bad company make

## Introduction

- Still, regulators, major investors, governments, other corporate stakeholders and the media are focusing on the effectiveness of boards
- Unprecedented scrutiny is a safeguard against complacency in the boardroom
- “The right thing to do”, based on a mix of knowledge and faith

## Introduction

- Interest in corporate governance first arose from concern about the effectiveness of boards of public companies
- Concern has now expanded to effectiveness of boards in Crown, voluntary and not-for-profit sectors (e.g., CPAs, hospitals, pension funds, etc.)

## Outline of Presentation

- Main Concepts of Corporate Governance
- Why CPAs Are Special and What That Means
- The “**Rules of Navigation**”: Good Governance Requirements under CMA, PAM Regulations, Letters Patent, Code of Conduct and Beyond
- Corporate Governance Advisory Program
- Future of Corporate Governance for CPAs

## “Corporate Governance” Defined

- Corporate governance involves the division of power and establishment of mechanisms for achieving accountability and transparency
  - accountability of management to board and stakeholders
  - transparency through public consultations, reports and meetings

## “Corporate Governance” Defined

- Corporate governance refers to the structures, processes, cultures and behaviors used to direct and manage the business and affairs of a company with the objective of enhancing the company’s ability to fulfill its mandate and to ensure its financial viability

## “Good Corporate Governance”

- Good corporate governance:
  - results in meaningful accountability, transparency, legitimacy and leadership
  - is action not rhetoric
  - is not a “one size fits all” proposition
  - is not an end in itself
  - arises from structures, processes and behaviors that fit a particular company’s needs and the culture of its board

## What Makes Boards Work?

- Governance is basic whenever human beings act together
- Are there common types of director behavior?

## 10 Director Behavior Types?\*

### Optimal

Conductor Chair

Change Agent

Consensus Builder

Challenger

Counsellor

### Dysfunctional

Caretaker Chair

Controller

Conformist

Critic

Cheerleader

\* As posited by Richard Leblanc and James Gillies in *Improving Board Decision-Making: An Inside View*, 2003

## What's Special About CPAs?

- CPAs are:
  - non-share corporations
  - with substantial legal autonomy
  - whose management is supervised by directors selected to be representative of industry, federal, provincial and municipal concerns

## What's Special About CPAs?

- Are CPAs “Crown corporations” within Part 10 of the *Financial Administration Act* (Canada)?
- No, because (a) Cabinet appoints only 5 of 7 directors (so not “wholly-owned directly by Crown” per s. 83(2)(2)(b) which requires “all” directors to be so appointed) and (b) s. 24 of CMA restricts application of FAA to CPAs
- Yes, because s. 83(8) (which relates specifically to corporations without share capital - like CPAs - requires only a “majority” of directors to be so appointed)

## What's Special About CPAs?

- A nice point but why should you as CPA directors care? Because an argument supporting the “no” answer might be used by the Crown to deny CPA directors the benefit of the “mandatory” Treasury Board Indemnity in s.119 (see **tab 16**)
- ACPA should consider asking Crown to clarify its support of CPA directors by granting in writing a “permissive” indemnity to the same effect (at least with respect to the risks to directors associated with their discharge of a CPA’s “public policy” (as opposed to “commercial”) objectives – e.g., ensuring marine safety and security)

## What's Special About CPAs?

- CPAs are “Agents of Her Majesty in Right of Canada”
  - for so-called “core” activities (such as those related to shipping, navigation, transportation of passengers and goods, handling of goods and storage of goods)

## What's Special About CPAs?

- CPAs are not "Agents of Her Majesty in Right of Canada" for so-called "non-core" activities
  - i.e., activities deemed in the CPA's letter patent to be necessary to support port operations, such as
    - borrowing
    - dealing with real property
    - establishing subsidiaries

## What's Special About CPAs?

- CPAs have the challenge of:
  - operating as unique agent/non-agent hybrids
  - effectively fulfilling their mandates
    - » which have both commercial and public policy objectives

## What's Special About CPAs?

- Commercial objectives include:
  - being financially self-sufficient
  - managing marine infrastructure in a manner that takes into account users and community in which a port is located
  - ensuring that marine transportation services are organized to satisfy needs of users and are available at reasonable cost to users

## What's Special About CPAs?

- Public policy objectives include:
  - implementing Canada's national marine policy
  - supporting the achievement of local, regional and national social and economic objectives
  - promoting and safeguarding Canada's competitiveness and trade objectives
  - harmonizing marine infrastructure and services with Canada's major trading partners
  - providing for high level of safety, security and environmental protection at ports

## Because CPAs are Special:

- CPA governance is more complex than the governance of public companies on which most reports and “best practices” of good corporate governance are based
- Tenets of good corporate governance must be tailored for CPAs

## Good Governance for CPAs

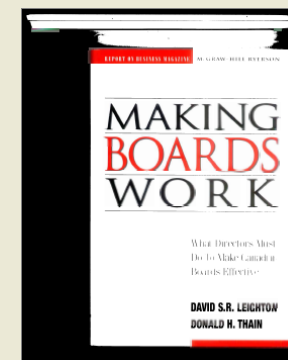
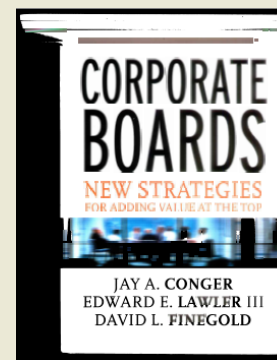
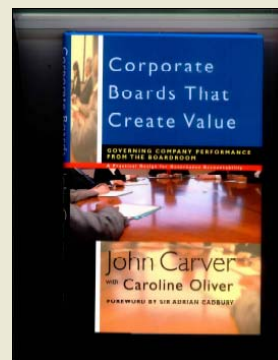
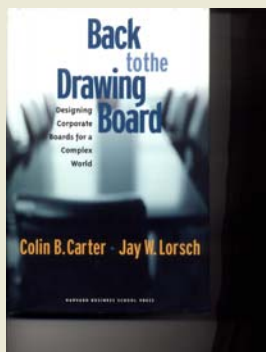
- Starting point is that CPA directors must know the “Rules of Navigation”

## CPA Corporate Governance Handbook: Source for “Rules of Navigation”

- Selected books, reports and papers (tabs 1-3)
- Excerpts from applicable legislation, regulations, constating documents and codes (tabs 4-9)
- Sample statements, terms of reference, position descriptions, evaluation forms and indemnities (tabs 10-16)

## The “Rules” in Books, Reports and Papers

- CPA Orientation Reference Manual, Transport Canada 1999
- Corporate Governance in Crown Corporations and Other Public Enterprises - Guidelines 1996



## The “Rules” in Laws, Regulations, Constating Documents and Codes

- See special requirements in:
  - *Canada Marine Act* (tab 4)
  - *Port Authorities Management Regulations* (tab 5)
  - CPA's *Letters Patent* (tabs 6 and 7) (especially Schedule F *Code of Conduct*) and *By-Laws*, if any
  - Other codes and requirements of CPA's board or authority appointing director (e.g., *Federal Conflict of Interest Code, 2003*) (tabs 8 and 9)

## *Canada Marine Act Requirements*

- Board has stewardship responsibility of “supervising” CPA’s management
  - don’t be fooled by the “power to manage” language in s. 20
- “Supervising” means directing the overall activities of a CPA through long range strategy, policies and directions to management
- It does not mean “managing” - let alone micro-managing!

## *Canada Marine Act Requirements*

- Senior officers manage day-to-day activities within framework laid down by board
- Directors and officers have duties (s. 22(1))
  - to act honestly and in good faith with a view to the best interests of the CPA
  - to exercise the care, diligence and skill that a reasonable prudent person would exercise in comparable circumstances
- Directors must have stature, knowledge and experience relevant to business, ports or maritime trade (s. 15)
- CEO can't be director, let alone the Chair (s.21(2))

## *Port Authorities Management Regulations* Requirements

- Provisions of other corporate statutes (i.e. *Canada Business Corporations Act* and *Canada Corporations Act*) don't apply to a CPA, unless the Regulations state that these Acts do apply (s.2)
- Part 2 - Directors and Officers
  - includes provisions for resolving conflicts of interest, liability of directors, due diligence defence, indemnification, audit committee and liability insurance

## *Letters Patent* Requirements

- Article 4 - Directors and Directors' Meetings
  - includes provisions for committees of the board and matters that cannot be delegated to a committee of the board (s. 4.15)
  - process for appointment of directors (s. 4.16)
  - nomination process for user directors (s. 4.17)
- Article 5 - Code of Conduct
  - see Schedule F to Letters Patent

## *Code of Conduct Requirements*

- Object of Code
  - Enhance public confidence in the integrity and impartiality of directors and officers of CPA and the business activities and transactions carried on by CPA by establishing clear conflict of interest rules (s. 1.1)

## *Code of Conduct Requirements*

- Each director and officer annually to acknowledge in writing that they have read the Code and are in compliance (ss. 1.6 and 1.8)
- Scope of Obligations
  - may require additional action to be taken beyond the specific requirements of the Code (s. 1.5)

## *Code of Conduct Requirements*

- Director and officer to:
  - avoid conflicts (or at least manage and resolve them as they arise through disclosure to board and absenting self from meeting)
  - follow disciplines for acceptance or offering of gifts
  - not to use corporate information for personal benefit

## Requirements Beyond *Code of Conduct*

- Voluntary compliance by director or officer with measures in Code (i.e., divestment, withdrawal or resignation) does not relieve:
  - the director from complying with such other measures as the entity appointing the director determines to be appropriate; or
  - the officer from complying with such other measures as the board determines to be appropriate (s. 4.2)

## Requirements Beyond *Code of Conduct*

- Example: *The Conflict of Interest and Post-Employment Code for Public Office Holders, 2003*
- See 2003 letter from Office of Ethics Counsellor re: CPA directors as part-time GIC appointees



## Requirements Beyond *Code of Conduct*

- Section 19 of CMA permits director to be removed “for cause” by the entity that made the appointment (or, curiously, by the “other directors”)
- Office of Ethics Counsellor appears not to initiate investigations but responds to complaints

## Requirements Beyond *Code of Conduct*

- According to statements of the Ethics Counsellor, CPA directors, as part-time GIC appointees, have limits on their “political activities” while they remain on the board, which appear to include:
  - not running for political office
  - not managing the campaign of someone running for political office
  - not attending political party conventions (*Ottawa Citizen*, August 5, 2003, “Patronage Appointees Told to Skip Liberal Convention”)

## Requirements Beyond *Code of Conduct*

### *Code of Business Ethics*

- For directors, officers and other employees
- To deal with matters such as:
  - compliance with laws and regulations
  - record keeping and confidentiality
  - protection and proper use of CPA assets
  - reporting of illegal and unethical behavior

## Ensuring Compliance: What's a CPA Corporate Governance Advisory Program?

- An integrated program designed to:
  - assist CPAs and their boards
    - to comply with legal requirements and
    - to develop their own "best practices"
  - provide practical governance advice
  - reduce exposure of directors and officers to personal liability and reputational risk

## Ensuring Compliance: What's a CPA Corporate Governance Advisory Program?

- A customized program which includes:
  - a comprehensive governance "audit"
  - a report on what is necessary to bring governance up to required standards
  - orientation and ongoing education for directors and officers on CPA governance matters
  - access to a panel of experienced directors and senior lawyers for timely, confidential and practical advice on specific CPA governance issues
  - risk management strategies and advice to maximize the benefits of indemnities and liability insurance

# The Governance Audit

- A comprehensive governance audit involves:
  - objective, outside counsel
    - working with directors, officers (and governance committee, if one exists)
    - to examine current governance structures, processes, policies, behaviors and cultures in accordance with the special requirements applicable to CPAs
- It verifies compliance with and examines organizational awareness of governance mandates

# The Governance Audit

- It assesses board governance structures and processes including:
  - mandate of corporate governance committee, if any (tabs 10 and 11)
  - mandate of other committees, including audit and nominating committees
  - corporate governance manual, including code of business conduct and ethics (tabs 12 and 13)

## The Governance Report

- Following the governance audit, outside counsel will prepare a report to the CPA's board:
  - highlighting problems with governance structures, processes and behaviors in light of the special legal requirements for CPAs
  - making recommendations to bring a CPA's governance up to required standards, if necessary

## The Governance Report

- The report will also highlight where orientation and ongoing education for directors and officers on governance matters is required
- Recommendations will be made for improving the knowledge and skills of directors and officers

## Learning About Better CPA Governance

- ACPA's CPA Governance Seminar
- General and CPA-specific governance seminars, workshops and retreats run by external consultants

## Learning About Better CPA Governance

- Going back to school:
  - i.e., *Corporate Governance College* (JV between Institute of Corporate Directors and U of T's Rotman School of Management) and *The Director's College* (JV between the Conference Board of Canada and McMaster's DeGroote School of Business)
  - Director's College adding more courses for directors - *The Globe & Mail*, November, 2004

# Going back to school




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*"The Directors Education Program fulfilled my needs and expectations as an experienced Director and board advisor. Essential topics for objectively understanding corporate governance issues and a professional Director's responsibilities were analyzed with stimulating, interactive presentations and realistic case studies. This program was also the first step in enabling me to achieve the designation ICD.D, a certified professional Director."*

H. Garfield Emerson, QC, ICD.D  
DEP 1 Graduate  
National Chair, Fasken Martineau DuMoulin LLP  
Chairman of the Board, Rogers Communications, Inc.

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## Continuing Education and Evaluation

- Once oriented, directors require continuing education:
  - to address changes in the regulation of governance matters
  - to deal with specific governance issues as they arise
- Regular evaluation of board and individual directors is important (tab14)

## Role of Outside Legal Counsel

- Outside legal counsel can provide CPA's board with access to experienced panel for confidential and practical advice
- **Advice by panel will be protected by solicitor-client privilege**

## Risk Management, Indemnities and Insurance

- Ensure integrated approach so that risk management strategies, indemnities and insurance work in tandem to protect interests of CPA and its directors and officers

## Risk Management

- Outside counsel can:
  - review a CPA's risk reduction strategies in light of the recommendations of periodic risk assessments and the comprehensive risk assessments mandated by the *Port Authorities Management Regulations*
  - assess those CPA-developed strategies against others developed by outside counsel

## Indemnities

- Mandatory/Permitted/Prohibited
- Indemnity in By-law or by Contract
- See sample CPA Director's Indemnity (tab 15)
- See Treasury Board Indemnity under s. 119 *Financial Administration Act* (tab 16)

# Insurance

- Outside counsel can:
  - review coverage and exclusions in D&O insurance policies in the context of the special risks to which CPA directors and officers are exposed
  - assist in making an informed decision to purchase such insurance (particularly if the coverage is over and above that typically offered by insurer)
  - help with the cost/benefit analysis that takes into account:
    - the cost of the insurance
    - the scope of coverage, including deductibles and policy limits
    - the likelihood of a claim under the policy
    - the need to provide appropriate coverage to attract and retain highly qualified directors and officers

## Costs of CPA Governance Program

- Depend on scope of services and degree of customization
- Initial consultations should be at no cost to CPA
- Budget and hourly rate approach may not make sense
- Consider flat-fee approach (i.e., fixed fee for governance audit and report and periodic retainer for ongoing education of and advice to directors and officers)

## Sample Timeline and Budget for Advisory Program

- Governance Audit (2-4 weeks)  
\$5K-\$20K
- Compliance Report (1-2 weeks)  
\$2K-\$10K
- Ongoing Education and Advice (\$4-6K/quarter)  
\$16K-24K

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**TOTAL \$23K-\$54K in first year, \$16K-24K/year thereafter**

## Future of Corporate Governance for CPAs

- Governance law and practice are in state of rapid change and the bar is being raised (*Sarbanes-Oxley Act, 2002*, new NYSE Rules, new CSA Rules)
- Scrutiny of governance by regulators and stakeholders will only increase
- CMA Review and Reform
  - governance on the radar

## CMA Review Panel Submissions, Fall 2002

- Many stakeholders (including CPAs, municipalities, provinces and users, along with the Competition Bureau) made submissions to improve the corporate governance of CPAs

## CMA Review Panel Recommendations May 2002

- Minister should nominate individuals for CPA board from a list of nominees submitted by the user nominating committee
- Minister should then only be able to nominate other qualified individuals in the event that the committee proposes an insufficient number of candidates
- CMA should be amended to allow a person who is a director, officer or employee of a user to sit on a CPA board of directors

Some Concluding Thoughts:  
“For Effective Corporate Governance, Keep  
Politics Out of the Boardroom”

- CMA Review Panel did not question the wisdom of, or make a recommendation to change, s. 16 of the CMA which prohibits politicians, officers or employees of municipal, provincial or federal governments from being directors of CPAs

## Some Concluding Thoughts: “Who Wants the Mayor on their Board?”

- There is no compelling “effective governance” argument to make the Mayor a CPA director (let alone the Chair) and thereby “unduly politicize” its board
- CPA is already “accountable” to the City in which it is located through the City’s power to appoint one director (s. 14(1)(b)) and its power to remove that director “for cause” (s. 19(1)(c))

## Some Concluding Thoughts:

“What’s the latest word from our top court?”

- Earlier this month, the Supreme Court of Canada released its decision in *Peoples Department Stores v. Wise*, now Canada’s leading case on directors duties
- The SCC commented on director liability and corporate governance standards

## *Peoples Department Stores v. Wise* What the SCC Said

- *" The establishment of good corporate governance rules should be a shield that protects directors from allegations that they have breached their duty of care. However, even with good corporate governance rules, directors' decisions can still be open to criticism from outsiders."*

## *Peoples Department Stores v. Wise* What the SCC Means

- Absence of proper corporate governance structures will be held against a corporation BUT presence of governance structures does not end the analysis
- Corporate governance structures are a means to an end - that is, an effective, independent-minded board

# Questions



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