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Shareholder Proposals in Canada

Shareholder proposals are becoming more common across Canada – impacting the governance of Canadian public companies. Over the last decade, the number of proposals filed by shareholders in the U.S. and in Canada has increased. In a 2012 study, Dr. Oshionebo analyzed shareholder proposals filed with Canadian corporations between 2000 and 2011, and observed that a large majority of proposals submitted addressed corporate governance issues and that the noted increase in the number of proposals was the work of a few activist shareholders. In a similar study published in 2016, Kumar reviewed the major proposal trends of the 2015 American proxy season, observed that proposals on board composition continued to increase and that the level of approval on say-on-pay proposals remained high. In this article Vitale Santoro, Eleonore Derome & Marion Racine examine the proposals submitted for the 2016 proxy season in Canada, and highlight the key trends by industry and subject matter.

Dual Class Share Structures

While there are valid criticisms of dual class shares, as there are with other corporate governance policies, there is no justification for a ban on dual class share structures. In fact, there is insufficient evidence to tip the scales against dual class shares and many scholars have pointed to the benefits of using dual class share structures. Securities regulators should be cautious in placing unnecessary restrictions on these structures - and we all need to recognize that dual class share structures are here to stay. In this article, Thomas Fenton examines this debate on dual class shares in Canada.

Regulating Online Lending Platforms

On October 24, 2016, the OSC announced its new innovation hub "Launchpad" for market participants in the fintech area to "help companies navigate" and possibly "tailor" the securities regulatory framework. The OSC also approved the registration of an AngelList subsidiary as a restricted dealer to operate its online networking and capital raising platform for angel investors and start-ups; as well as approved the registration as an exempt market dealer of a Lending Loop's subsidiary to operate its online lending platform. In this article, Barbara Hendrickson looks at recent securities regulation of online lending platforms.

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SHAREHOLDER PROPOSALS IN CANADA: THE 2016 PROXY SEASON TRENDS

Vitale A. Santoro[1], Eleonore Derome[2] & Marion Racine (student)
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Shareholder proposals are becoming more common across Canada – impacting the governance of Canadian public companies. Over the last decade, the number of proposals filed by shareholders in the U.S.[3] and in Canada[4] has increased. In a study published in 2012 by Dr. Oshionebo in which he analyzed shareholder proposals filed with Canadian corporations between 2000 and 2011, the author observed that a large majority of proposals submitted addressed corporate governance issues, and that this noted increase in the number of proposals was the work of a few activist shareholders.[5] In a similar study published in 2016, Kumar reviewed the major proposal trends of the 2015 American proxy season, and observed that proposals on board composition continued to increase and that the level of approval on say-on-pay proposals remained high.[6] In this article we examine the proposals submitted for the 2016 proxy season in Canada, and highlight the key trends by industry and subject matter.

METHODOLOGY

We analyzed shareholder proposals filed with the top 150 TSX listed reporting issuers ranked by market capitalization, as listed under the Royal Bank of Canada's ranking dated March 2016 (the "Top 150 TSX issuers"). The average market capitalization of the Top 150 TSX issuers is $13 billion. We examined the data from the public filings of the issuers available on SEDAR for the period beginning July 2015 to June 2016[7] (the "2016 proxy season"). All the proposals submitted to the Top 150 TSX issuers were taken into account, including those that have been withdrawn after submission because management and shareholders reached an agreement. Indeed, we included those proposals in our sample because they reflect the interests and intentions of some shareholders, and force the board of the issuer to respond and take a position on the issue raised by the proposal. In total, 51 proposals have been submitted to 23 of the Top 150 TSX issuers examined.

OVERVIEW OF THE DATA AND TRENDS

According to our analysis, approximately 60% of total proposals were voted on, whereas the others have been withdrawn. Only one proposal was officially supported by the board in the corporation's information circular. This proposal on climate change risk was submitted by a mutual fund company and is the only proposal that attracted majority support at the general annual meeting. The average total voting for all the proposals is 12% for and 84% against, with the remainder abstaining. Moreover, approximately 55% of submitted proposals target a bank or an insurance company, and the most common matter of proposal relates to the board composition (approximately 29%), followed by executive compensation (approximately 15%), the presentation of voting results (approximately 10%), simplification of financial statements (approximately 10%) and disclosure of measures to increase customer satisfaction (approximately 8%). The other categories relate to the issuer's participation in the effort to optimize Quebec's public finance by paying incremental taxes (approximately 8%), human rights and work conditions (approximately 6%), corporate social responsibility (approximately 4%), length of the appointment of external auditors (approximately 4%),

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[3] Rajeev Kumar, "2015 Annual Corporate Governance Review", *Harvard Law School Forum on Corporate Governance and Financial Regulation* (February 12, 2016), online: <https://corpgov.law.harvard.edu/2016/02/12/2015-annual-corporate-governance-review/>.

[4] Evaristus Oshionebo, "Shareholder Proposals and the Passivity and the Passivity of Shareholders in Canada: Electronic Forums to the Rescue", (2012) 37:2 *Queen's LJ* 619 at 635.

[5] Oshionebo, *supra* note 4, at 643.

[6] Kumar, *supra* note 3.

[7] As at the date of this article, CAE Inc. and Saputo Inc.'s annual general meetings are pending. A proposal relating to the board composition and a say-on-pay proposition is set forth under Saputo Inc.'s Management Proxy Circular dated June 2, 2016.

climate change risk (approximately 4%) and lobbying activities (approximately 2%). Targeted issuers tend to have a higher market capitalization.

FINANCIAL SERVICES INDUSTRY: THE MAIN TARGET FOR PROPOSALS

A trend that we can observe from our data is that the market capitalization of an issuer is positively correlated with the number of proposals it receives. Financial institutions [8] have been the target of approximately 55% of the proposals we analyzed. The Bank of Nova Scotia is the only bank in the Top 150 TSX issuers that has not been targeted by a proposal; conversely Industrial Alliance Insurance and Financial services Inc. ("Industrial Alliance") is the only insurance company that has been targeted by a proposal.

During the 2016 proxy season, the shareholder *Mouvement d'éducation et de défense des actionnaires* ("MÉDAC"), which presented approximately 75% of the total shareholder proposals across Canada filed during the 2016 proxy season, filed the same four proposals with three banks, requesting: (1) simplification of financial statements; (2) to participate in the effort to optimize Quebec's public finance by paying incremental taxes; (3) to implement a renewal policy; and (4) to disclose information about the bank's strategy to increase consumer satisfaction. Amongst these, only proposals about simplification of financial statements and optimization of Quebec's public finance have been submitted to vote, with the average voting against reaching approximately 98%.

BOARD COMPOSITION: THE PRIMARY SUBJECT MATTER

Board diversity has drawn the attention of shareholders and authorities over the last few years, and still represents the primary subject matter within the board composition category. Corporate governance experts generally believe that the interplay of different backgrounds and qualifications positively impacts board and corporation performance and that "new and different ideas will more likely come from boards that are diverse in race, gender, background and experience and that have appropriate levels of independence."[9]

According to our analysis, proposals about the board composition combine five types of resolutions, namely proposals requesting: (1) the issuer to adopt a policy or specific targets and deadlines concerning board members' diversity (approximately 47%); (2) to adopt a renewal policy with a maximum term of 15 years for independent directors (approximately 27%); (3) to nominate more directors with a specific expertise (approximately 13%); (4) to provide the information about the skills and experience of the directors through a matrix in the management circular (approximately 7%); and (5) to disclose efforts made to better understand concerns of the shareholders abstaining to vote for the election of the directors (approximately 7%). All proposals requesting a renewal policy have been proposed by MÉDAC, and after a discussion with the board, all have been withdrawn. Issuers targeted by a proposal on renewal policy have responded positively and already had guidelines about prohibiting directors from seeking renewal of their mandate after 15 years.

Regarding board diversity, the 2014 amendments to National Instrument 58-101 *Disclosure of Corporate Governance Practices* requesting the disclosure of the measures taken - or not taken and why - by the issuer in order to increase the representation of women on boards and senior management have encouraged issuers to adopt a written policy. Despite this regulatory reform, shareholder proposals on gender diversity on boards continued to represent a prominent subject matter during the last proxy season. It is interesting to note that some targeted issuers already have a policy, and that the proposal is asking to do more than what is requested by the authorities by setting specific targets and deadlines. Also, if the proposed changes recently introduced in Bill C-25 *An Act to amend the Canada Business*

[8] Financial institutions we examined include the Royal Bank of Canada, The Toronto-Dominion Bank, the Bank of Montreal, the Canadian Imperial Bank of Commerce, the National Bank of Canada, Power Corporation of Canada and Industrial Alliance.

[9] Glass Lewis, "Mind the Gap: Board Gender Diversity in 2014" by Courteney Keatinge (February 26, 2015), online: <http://www.glasslewis.com/glass-lewis-publishes-mind-gap-board-gender-diversity-2014>.

Corporations Act, the Canada Cooperatives Act, the Canada Not-for-profit Corporations Act and the Competition Act are adopted, directors of certain *Canada Business Corporations Act* corporations would be required, *inter alia*, to send their shareholders information relating to diversity. Bill C-25 also aims to simplify determination of the submission period of shareholder proposals.

EXECUTIVE COMPENSATION PROPOSALS: SAY-ON-PAY PROPOSALS REMAIN POPULAR

More than two-thirds of the proposals on executive compensation were say-on-pay proposals requesting an advisory vote to provide shareholders a formal opportunity to give their views on the Board's approach to executive compensation. One proposal was withdrawn after the board resolved to hold an advisory vote at the annual meeting.

As opposed to the U.S. where say-on-pay is mandatory, Canadian issuers may voluntarily adopt an advisory vote policy, and in 2014, 80% of the largest issuers in Canada did so.[10] Over the past few years, the number of issuers that have been targeted by a say-on-pay proposal remained relatively constant; however, we noted that even though the number of proposals has remained relatively static, the shareholder approval level diminished in 2016. During the 2016 proxy season, proposals seeking a say-on-pay vote received a 16% approval rate on average, none of them received the majority support, and all were filed by one shareholder, MÉDAC. Each issuer's response to the proposal indicated that they firmly believed that the corporation's directors, with the support from external consulting firms, were in the best position to oversee the executive compensation arrangements. Furthermore, we noted that advisory vote proposals were filed with issuers with an average market capitalization of approximately $16 billion, and that these issuers were not in their first year of being the target of a say-on-pay proposal. Therefore, it seems that some lower market capitalization issuers still resist the advisory vote with the support of their share owners, even after being the target of a say-on-pay proposal for successive years.

U.S. TRENDS THAT EMERGED IN CANADA

Climate Change Risk Disclosure

The global turn toward a low-carbon economy characterized by the increased spending in renewable technology, along with the rise of climate-related catastrophes, has raised concerns from shareholders about corporate strategies. During the 2016 proxy season in the U.S., many oil and gas corporations have faced shareholder proposals on climate change risk, but none of them received support from the majority of shareholders. In Canada, two corporations out of the Top 150 TSX issuers faced such a proposal in 2016: Suncor Energy Inc. ("Suncor") and Industrial Alliance. In the case of Suncor, shareholders used the proposal to seek additional disclosure about how "key risks are being mitigated and position the company as a long-term energy investment of choice."[11] The proposal submitted by NEI Investments, a mutual fund company, attracted majority support (98%) at the annual general meeting after being officially supported by management. In contrast, the proposal filed by two individuals for Industrial Alliance focused on the potential increase of climate-related insurance claims, and obtained an approval rate of 3% at the annual meeting.

In Canada, corporations are not required under legislation to interpret the impact of external political, economic or social developments on their activities and affairs, unless they meet the criteria of a material change under securities law.[12] More specifically, the policy statement of the TSX on timely disclosure

[10] Amy Knieriem, and Michael A. Thompson, "Executive Remuneration Perspective For Better or For Worse: Say-on-pay Comes to Canada" (February 2014), *Prospective*, online: <http://www.mercer.ca/content/dam/mercer/attachments/north-america/canada/Perspective-02-2014-Say-On-Pay-Comes-To-Canada.pdf>.

[11] Suncor Energy Inc., "Management Proxy Circular" (February 25, 2016), at A-2.

[12] *National Instrument 51-102 Continuous Disclosure Obligations*, section 7.1.

requirements mandates that political developments and their particular impact on the company must be disclosed if they had or will have a direct effect on its affairs that is material and "uncharacteristic of the effect generally experienced as a result of such development by other companies"[13] engaged in the same business or industry. Moreover, corporations can publish on a voluntary basis a sustainability report disclosing their carbon intensity mitigation efforts, and other risks and challenges faced by the company regarding climate change and the transition towards a low-carbon economy. We can potentially expect this proposal to be submitted to Canadian issuers over the next few years owing to the influence of the U.S., where we observe an increase in the number of submitted climate-risk proposals and year-over-year increases of support by more institutional investors, such as pension funds.[14] Given the rising acknowledgment by stakeholders that climate change constitutes a risk, we can expect increased activism regarding the importance of having accurate data relating to this subject matter so that the financial industry may more accurately monitor portfolios.[15]

Political Lobbying Expenditures Disclosure Proposal

In 2013 and 2014, proposals regarding the disclosure of corporate political spending became the most frequently submitted shareholder proposals in the U.S.,[16] most of them requesting greater transparency and a minority asking for the adoption of board oversights or required shareholder approvals of political spending. The global voting proxy advisory firm Institutional Shareholder Services recommends corporations vote for proposals requesting greater disclosure and against proposals barring corporate political spending.[17] In 2016, out of the Top 150 TSX issuers, only Suncor received a shareholder proposal asking for increased disclosure on direct and indirect lobbying and grassroots lobbying communications spending. The proposal, filed by a group of shareholders, achieved only 40% support.

Proposed resolutions on political lobbying disclosure usually cite "reputational risk", and are supported by literature stating that high political lobbying spending is correlated to lower firm value,[18] a trend that until recently has been challenged by other scholars.[19] The political sensitivity of those proposals has been illustrated in a recent study in the U.S., which shows that politically active firms tend to be more targeted by shareholder proposals seeking additional corporate political activity disclosure,[20] and that unions and public pension funds submit more proposals targeting left-wing leaning firms, measured by the firms' campaign contributions.[21] In the end, taking into account the influence of the U.S., and the high shareholder support Suncor's proposal received, it would not be surprising to observe an upward swing in political lobbying spending disclosure proposals over the next several years in Canada.

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[13] Toronto Stock Exchange, "Policy Statement on Timely Disclosure", p. 3.

[14] Bradley Olson, and Nicole Friedman, "Exxon, Chevron Shareholders Narrowly Reject Climate-Change Stress Tests", *The Wall Street Journal* (May 25, 2016), online: <http://on.wsj.com/29GyZjR>.

[15] BlackRock, "The Price of Climate Change: Global Warming's Impacts on Portfolios" (October 2015), *BlackRock Investment Institute*, online: <https://www.blackrock.com/corporate/en-mx/literature/whitepaper/bii-pricing-climate-risk-international.pdf>.

[16] Geeyoung Min, and Hye Young You, "Active Firms and Active Shareholders: Corporate Political Activity and Shareholder Proposals." (April 30, 2015) *Virginia Law and Economics Research Paper No. 15, Virginia Public Law and Legal Theory Research Paper No. 28*, at 14.

[17] Institutional Shareholder Services, "2016 Benchmark Policy Recommendations: Canada Proxy Voting Guidelines for TSX-Listed Companies" (December 18, 2015), online: <https://www.issgovernance.com/file/policy/2016-canada-tsx-voting-guidelines-jan-2016.pdf>.

[18] See Alexander Borisov, Eitan Goldman, and Nandini Gupta, "The Corporate Value of (Corrupt) Lobbying" (2016) 29:4 *Rev. Financ. Stud.* 1039.

[19] See Michelle Hutchens, Sonja O. Rego, and Amy Genson Sheneman, "Influencing Profits: The Differential Impact of Lobbying on Corporate Stock Returns", (April 29, 2016) *Kelley School of Business Research Paper No. 16-41*.

[20] Min, and You, supra note 15, at 26.

[21] Min, and You, supra note 15, at 25-26.

Proxy Access Resolutions: The Future of Canadian Shareholder Proposals?

Proxy access is a mechanism that gives shareholders the right to place their nominees for director on a company's proxy circular, thus avoiding the cost of sending their own circular. Existing federal and provincial corporate laws provide shareholders with ways to participate in the nomination process. Pursuant to the *Canada Business Corporations Act*, a registered shareholder can always be active in the director nomination process by requisitioning a meeting to elect or revoke directors, and by submitting a shareholder proposal to nominate directors to be included in the company's annual proxy circular – provided that the proposal is signed by at least one shareholder representing in the aggregate more than 5% of the voting shares. However, there is no statutory requirement for management to include information about the shareholder's nominee(s) with the same prominence and location in the proxy circular.

In the U.S., a total of 110 proxy access shareholder proposals were filed in 2015, of which 88 went to a vote. On average, close to 54% of votes cast were in favor of these proposals, and 52 received majority support,[22] In Canada, we do not observe the same trend as in the U.S., as no proxy access proposal has been presented in the 2016 proxy season. This could be due to the fact that Canadian law is different and already offers shareholders a say in the identity of the nominees, but we also note that the approach proposed by the Canadian Coalition for Good Governance would extend the legal system currently advocating for a legislative reform in order to introduce more favorable proxy access mechanism provisions and permit shareholders to utilize the company's proxy circular for their proxy solicitation.[23]

OTHER PROPOSALS

Social responsibility of corporations has been targeted by three different shareholder proposals, the first being the request of an advisory vote on the company's philanthropic approach; the second a cost-benefit analysis of a living wage policy; and the third for the company to make an independent assessment of its human rights responsibilities regarding its operations in Africa.

The corporations' policies regarding the appointment of external auditors have also raised the attention of shareholders of the Canadian National Railway Company and Enbridge Inc. The investor Qube Investment Management Inc. presented a proposal requesting to limit the corporation's external auditors' mandate to a total of 8 years. This proposal obtained the support of approximately 4% of shareholders.

Four Quebec-based corporations have been targeted by shareholder proposals seeking that the company disclose voting results by classes of shares, namely shares carrying one voting right and those carrying multiple voting rights, arguing that this measure would ensure "adequate protection" for the minority shareholders. Each of these corporations was "family-owned." The board recommended voting against the proposal in each case, with the exception of Quebecor Inc., where the board agreed to disclose voting results separately prior to the annual meeting in order to favor a "sustained dialogue with its shareholders."[24] On the other hand, the management of the three other family owned corporations believed that there was no practical or legal reason for disclosing the voting results separately. These proposals achieved on average 16% of shareholder approval.

CONCLUSION

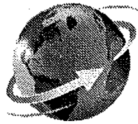
Overall the shareholder proposal mechanism supports good corporate governance by creating a dialogue

[22] Kumar, *supra* note 3.

[23] Canadian Coalition for Good Governance, "Shareholder Involvement in the Director Nomination Process: Enhanced Engagement and Proxy Access" (2015), *CCGG Policies*, at 17.

[24] Quebecor Inc., "Notice of Annual Meeting of Shareholders and Management Proxy Circular 2016" (March 29, 2016), at 67.

between shareholders and the board on fundamental matters such as board composition, executive compensation, corporate social responsibility and greater transparency. Our data suggests that board composition remains an important topic of discussion for shareholders. It was the most common subject matter during the 2016 proxy season, and the issue with the highest level of approval with the exception of Suncor's proposals on climate-change risk, which obtained majority support, and the proposal on lobbying expenditures. Financial institutions, the majority of which are Canadian issuers with some of the highest market capitalizations, have been the main targets, accounting for approximately 55% of all proposals. The vast majority of these proposals have been submitted by one group of shareholders, MÉDAC, which generally submitted the same proposals. Furthermore, in reviewing past U.S. shareholder proposal trends, one could expect shareholder proposals relating to climate change risk disclosure and political lobbying expenditure disclosure to increasingly become the target of activism in the coming years.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HERE TO STAY – DUAL CLASS SHARE STRUCTURES

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Professor Anita Anand of the University of Toronto speaks in absolutes when describing dual class share structures. According to her, it is an "incontrovertible truth" that dual class shares undermine corporate governance standards.[2] With respect, her position is overstated. While there are valid criticisms of dual class shares,[3] as there are with other corporate governance policies, there is no justification for a ban on dual class share structures. In fact, there is insufficient evidence to tip the scales against dual class shares and many scholars have pointed to the benefits of using dual class share structures. Securities regulators should be cautious in placing unnecessary restrictions on these structures - and we all need to recognize that dual class share structures are here to stay.

THE ROLE OF REGULATORS

Securities regulators in Ontario, as with other jurisdictions, have a mandate to protect investors and foster fair and efficient capital markets. Dual class shares are "fundamentally unfair" in Prof. Anand's view because, among other things, they "silence investors by preventing them from participating in corporate decision-making."[4]

The implicit premise of Prof. Anand's argument is that it is only fair if shareholders have control proportionate to their financial risk. Since 'one share one vote' proportionality does not exist in dual class share structures, Prof. Anand has called on the Ontario Securities Commission (OSC) to act on their mandate to protect investors by eliminating, or at least restricting, these structures.

Prof. Anand's assumption that proportionate shareholder control is necessary for fairness and to protect investors ignores the market's ability to assess and price risk. Having a multi-voting class of shares may indeed insulate management from subordinate shareholder control - and this insulation does come with certain risks. But, it also comes with certain benefits, including a management team focused on a longer-term investment horizon. It would appear that investors are able to evaluate these risks and make decisions accordingly.

Shareholders routinely assess managers and the structure of management when determining where and how much capital to deploy. Evaluating the risks and benefits of a dual class share structure is part of this process. Regulators cannot protect investors from the risks that they ultimately decide to adopt in their investment decisions - and nor should they try to do so.

To protect investors, securities regulators have generally adopted mandatory forms of disclosure. To *ban* dual class share structures, as Prof. Anand calls on the OSC to do, would be to go far beyond the existing disclosure provisions that apply to dual class share companies.[5] The existing disclosure regime is designed to make it clear to investors in all promotional and any offering documents that any such shares being marketed are "restricted shares." Shareholders who hold subordinate shares are accordingly well advised of the situation – certainly in the case of an initial public offering or follow-on offering.

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[1] With assistance from Sean Green, Summer Student.

[2] The Success Stories of Dual Class Shares Miss an Incontrovertible Truth", *The Globe and Mail* (22 February 2016), online: <www.theglobeandmail.com>.

[3] Dual class share structures refer to multi-voting shares, non-voting shares and/or subordinate voting shares. Most commentators point to roughly 80 companies listed on the TSX with dual class share structures. These companies include AGF Management, Alimentation Couche-Tard, Atco Ltd., Bombardier, Canadian Tire, Canadian Utilities, CCL Industries, Celestica, CGI Group, Cogeco Communications, Corus Entertainment, Dorel Industries, Empire Company, Fairfax Financial Holdings, Transcontinental Inc., Jean Coutu Group, Onex Corp, Power Financial, Quebecor Inc., Rogers Communications, Shaw Communications, Teck Resources, Torstar, and TVA Group. List of companies from Ryan Modesto, "The case for investing in companies with dual-class shares", *The Globe and Mail* (18 April 2016), online: <www.theglobeandmail.com>.

[4] *Supra* note 2.

[5] See *Restricted Shares*, OSC Rule 56-501, part 2 for existing additional disclosure requirements.

COAT-TAIL PROVISIONS

There is a further notable requirement, beyond the disclosure obligations referred to in OSC Rule 56-501, that has been imposed by the Toronto Stock Exchange (TSX). Since 1987, the TSX has required "coat-tail provisions" for all new dual class share companies.[6] These provisions are designed to protect subordinate shareholders in the case of a buyout or take-over.

Under a coat-tail provision, the subordinate shareholder is entitled to equal participation in any formal bid to acquire multi-voting shares. The *Canadian Coalition for Good Governance* (CCGG) lists the inclusion of coat-tail provisions as a best practice for companies using dual classes.[7] They recommend these provisions be adopted for all reporting issuers, not just those listed on the TSX, and that the provisions should be standardized. Currently, TSX-listed companies must submit coat-tail provisions to the TSX for approval. This requirement was grandfathered in after 1987 and, consequently, there remain a few listed companies without coat-tail provisions.

Yvan Allaire, Executive Chair of the *Institute for Governance of Private and Public Organizations* (IGOPP), sees coat-tail provisions as removing "most of the potential financial benefits of control through a dual class of shares." [8] These provisions protect subordinate shareholders by ensuring they receive equal compensation in the case of a buyout. However, Prof. Anand would still prefer to see additional "procedural safeguards including a majority of the minority vote, a fairness opinion and a mandatory recommendation of a special committee of the board formed for the purpose of evaluating the transaction."[9] These are, perhaps, better seen as recommendations for best practice rather than potential regulatory driven rules/requirements.

SUNSET CLAUSES

Critics, including Prof. Anand, have called on regulators to implement mandatory sunset provisions for all dual class share companies.[10] A sunset provision establishes a date or time at which the dual class structure would collapse into a single class. This date may be after a certain period of time or upon the exit of the company's founder(s). The dual class structure would only remain if the subordinate shareholders elected to keep such structure after such date.

Most commentators agree that it is difficult to impose a standardized timeframe for a sunset clause because the situations vary considerably amongst companies. The CCGG recommends a dual class share structure remain for terms of up to five years, renewable upon a majority vote of the subordinate shareholders, after the initial collapse. The initial collapse should occur "at an appropriate time as determined by the board of the [dual class share] company and, if practicable, as set out in the [dual class share] company's articles." [11] It is difficult to understand what would constitute an appropriate time if, in a board of directors' opinion, the dual class structure was in the best interest of the company. As Prof. Allaire points out, a fixed-date sunset clause may lead to "all sorts of maneuvers on the part of controlling shareholders and various financial players."[12]

[6] *Restricted Securities*, TSX Company Manual, at s.624(l).

[7] Canadian Coalition for Good Governance, *Dual Class Share Policy*, Toronto: 2013 at 9. The CCGG also lists six other best practices for dual class share companies namely: (i) there should be a limit on the proportion of directors elected by multi-voting shares: (ii) multi-voting shares should have a meaningful equity stake in the company; (iii) reporting issuers should not have non-voting common shares; (iv) all dual class share structures should collapse at an appropriate time, unless a majority of outstanding subordinate shares approve the continuation of the structure; (v) a holder of multi-voting shares should not be allowed to monetize the holder's multi-voting shares by entering into a derivative transaction. If multi-voting shares are sold, they should automatically convert to subordinate-voting shares on a one-for-one basis; and (vi) no premium should be paid to the owner of the multi-voting shares upon a collapse of the dual class share structure.

[8] Yvan Allaire, "Enough with the shibboleth on dual class of shares" (2016) Institute for Governance of Private and Public Organizations, online: < medac.qc.ca> at 2.

[9] *Supra* note 2.

[10] *Supra* note 2.

[11] *Supra* note 7 at 10.

[12] *Supra* note 8 at 4.

The most obvious "appropriate time" to collapse a dual class structure, it would seem, would occur when a founding entrepreneur, or group of entrepreneurs, decides to step down as managers. If the dual class structure was initially designed to allow these entrepreneurs to control the company, it would therefore seem appropriate to consider collapsing the structure upon their departure. Prof. Allaire, however, takes issue with conceiving dual class shares as "a sort of indulgence granted to the founding entrepreneur."[13] He argues that is not how one should conceptualize dual class shares. He articulates, as do others, that there are many benefits for the company, not just for the multi-voting shareholders, to having dual classes.

THE BENEFITS OF DUAL CLASS SHARES

The most significant benefit of having a dual class share structure is that it shelters management from the pressures of managing for short-term results, allowing such managers to focus on long-term success. Prof. Allaire points to a higher level of sales growth and research and development for companies with dual classes. He also highlights the potential to borrow at a lower cost,

> [An] American researcher (Xu, 2014) has shown that the cost of borrowing was some 17 to 28 basis points *lower* for firms with dual class of shares. That makes perfect sense. Creditors would know that controlling shareholders with much of their wealth invested in the company (and who cannot easily sell their shares) will manage so that no default ever occurs on the debt as such an event would wipe out their entire wealth.[14]

Such benefits increase the appeal of dual class shares structures for both management and investors.

Dual class share structures also appeal to entrepreneur and family-run businesses that need access to capital in order to grow, but are looking to retain control over their businesses. Businesses in these situations may elect to participate in the capital markets only because a dual class structure is available. In this sense, regulators have to select between giving investors access to these companies on the public markets through dual class shares or denying them access altogether. These companies would not necessarily adopt a single class share structure in the public markets if dual class shares were banned and, without a dual class option, many companies would potentially remain private.

Takeovers by foreign bidders are a real risk to Canadian companies and dual classes are one of the few defenses available. Prof. Allaire goes so far as to assert,

> [w]ithout a controlling shareholder, without a dual class of shares, there would be no aeronautical industry in Canada, no C-Series to compete with Boeing and Airbus, a singular Canadian feat, no Magna in Ontario (a dual class company until 2010), no Rogers Communication, no Teck Resources, no Canadian Tire, no Weston, no CGI, no Shaw, and so on.[15]

His point is that regulators and critics should not undervalue the importance of dual class share structures for keeping business in Canada. Prof. Allaire forcefully declares "given the nature of financial markets these days, a dual class of shares provides a direct, transparent, and in Canada the only, way to insulate management from transient, short-term, agitators."[16]

CONCLUSION

The debate on dual class shares in Canada is not new. Why do the calls to ban dual class share structures persist? They continue because dual class share structures are the perfect lightning rod for discussions on the importance of shareholder control over management and the role of 'democracy' in corporate

[13] *Ibid.*
[14] *Ibid.*
[15] *Supra* note 8 at 1.
[16] *Ibid* at 4.

governance. Consider, for example, Stephanie Ben-Ishai and Poonam Puri's position that dual class shares "bear a striking resemblance to the undemocratic Canadian political environment predating suffrage" and that "dual class shares have created a class of second-class corporate citizens in Canada."[17]

Such overstatements reveal the abstract nature of the debate about dual class shares. In 1984, the OSC described their position as, "hopeful that the destiny of restricted shares in Canadian capital market can be determined by market participants rather than by regulators."[18] More than three decades later, market participants continue to invest in dual class shares. They have determined that dual classes are here to stay.

[17] Stephanie Ben-Ishai & Poonam Puri, "Dual Class Shares in Canada: An Historical Analysis." (2006) 29.1 Dal LJ 117 at 142.

[18] Cited in Ralph Shay, "Decades-old Controversy over Dual Class Shares Shows No Signs of Abating" *Securities Law Newsletter* (September 2015) Westlaw Canada.

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CANADIAN SECURITIES REGULATION OF ONLINE LENDING PLATFORMS

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BACKGROUND

On October 24, 2016, the Ontario Securities Commission ("OSC") announced its new innovation hub "Launchpad" for market participants in the fintech area to "help companies navigate" and possibly "tailor" the securities regulatory framework. The OSC Launchpad, which is said to be a first for Canadian securities regulators, follows on the introduction of similar models in the UK and Australia, and is designed to "accelerate time-to-market."

On October 24, 2016, the OSC also approved the registration of an AngelList subsidiary as a restricted dealer to operate its online networking and capital raising platform for angel investors and startups. http://www.osc.gov.on.ca/en/SecuritiesLaw_ord_20161024_angellist.htm

In addition, on October 24, 2016 the OSC approved the registration as of a Lending Loop subsidiary as an exempt market dealer to operate a online lending platform. This follows on the registration by the OSC in September of this year of a Lendified subsidiary, Vault Circle Inc., as an exempt market dealer to operate an online lending platform.

The registration of all three fintech platforms follows a seven-year hiatus in the registration of peer to peer lending platforms in Canada. The last and first registration of a P2P firm in Canada was CommunityLend Inc. which was registered by the OSC in 2009. During the seven-year period between CommunityLend's approval and the latest spat of registrations, a number of unregistered peer to peer firms initially attempted to set up shop in Canada, but later shut down their operations when faced with complying with securities requirements.

In 2015, in light of heightened activity and interest in this area, the OSC published its news release that warned this market that their activities may trigger dealer registration and prospectus requirements under Ontario securities laws. http://www.osc.gov.on.ca/en/NewsEvents_nr_20150619_peer-to-peer-lending.htm

OSC Staff Notice 33-747 *Annual Summary Report for Dealers, Advisers and Investment Fund Managers – Compliance and Registrant Regulation* further cautions the peer to peer lending market to consider their securities regulatory obligations before operating a P2P or lending platform (July 21, 2016). http://www.osc.gov.on.ca/en/SecuritiesLaw_20160721_sn_33-747_annual-rpt-dealers-advisers.htm

COMMUNITYLEND

The decision document for CommunityLend which was issued by the OSC on September 8, 2016 ("CommunityLend Order") is long and complex. Many of the prescribed conditions in the CommunityLend Order have been adopted in the AngelList, Vault Circle and Lending Loop online platforms registrations.

CommunityLend's peer to peer model was extremely innovative when it was introduced. http://www.osc.gov.on.ca/en/SecuritiesLaw_ord_20090911_215_communitylend.jsp

CommunityLend Inc. was registered as a limited market dealer (the precursor of the exempt market dealer category) and as a restricted portfolio manager by the OSC, the British Columbia Securities Commission and the Autorité des marchés financiers (AMF). Like AngelList and vault circle, CommunityLend was restricted to investors/lenders who were accredited investors. Its online bidding process allowed issuers / borrowers to syndicate short term consumer loans up to $25,000 to multiple investors/lenders.

Certain of the provisions of the CommunityLend Order reflect the fact that it was issued before the current NI 31-103 regime came into force. However, the majority of the provisions prescribe in detail how CommunityLend was required to operate its online peer to peer lending platform covering, among other things, the contents and structure of its website; the terms of agreements with borrowers and lenders; registration

process for both lenders and borrowers; identity verification; terms of the loans; the loan request process; acceptable investment limits; certification of accredited investors; the loan default process; contents of disclosure; acceptable fees; advertising and related party considerations.

CommunityLend ceased operating its peer to peer lending platform in 2012 when its principals went in another direction - "Financeit" a cloud based point-of-sale financing platform.

LENDIFIED/VAULT CIRCLE INC.

The loans offered on the Vault Circle lending platform include "high yield Canadian small business loans from creditworthy businesses." Vault Circle's registration as an exempt market dealer, which is not time limited, is subject to the following conditions. Vault Circle must:

- operate an online lending platform only in Ontario and only in reliance on the accredited investor exemption; and
- have reasonable access to issuers/borrowers books and records that it approves for distribution on the lending platform.

LENDING LOOP/ LOOP SECURITIES INC.

Loop Securities Inc., which is registered as an exempt market dealer in all Canadian jurisdictions, has a two-year time limited registration. Loop Securities is registered to distribute "payment dependent notes" ("Notes") issued by an affiliate of Loop Securities Inc. - Loop Funding Inc., relying on the offering memorandum exemption. Loop Securities has a number of additional conditions on its registration due to the "novel" nature of it offering. Loop Securities must:

- maintain reasonable access to the books and records of any issuer on the platform;
- report the following information to the OSC on a quarterly basis: the amounts of the Notes that were successfully funded, the Notes that were removed from the platform because they were not funded; any defaults on the Notes or amendments to payment schedules;
- provide the OSC with 30 days advance notice of material changes to the credit assessment or underwriting process of Loop Funding Inc.; and
- report the following to the OSC on a quarterly basis: investment transactions by investors; types of investors approved for access to the platform and the details of investor complaints.

ANGELLIST/ANGELLIST LLC AND ANGELLIST ADVISORS LLC

AngelList was registered to operate in Ontario an online platform and offers a number of services to start up businesses primarily in the technology sector including services to facilitate venture capital and angel investing. The OSC approved a startup funding platform for AngelList LLC ("AngelList LLC") and AngelList Advisors, LLC ("ALA") on October 24, 2016 on the basis of a two-year test period in light of the "novel" nature of their business. ALA was registered as a restricted dealer in Ontario to facilitate the syndication of offerings through its platform. All investors on the AngelList platform must be accredited investors. AngelList LLC is responsible for operating the online platform. The decision issued by the OSC on October 24, 2016 ("AngelList Order") provides relief from certain registrant obligations in NI 31-103 and the prospectus requirements of the Ontario *Securities Act*.

AngelList has extensive conditions attached to its registration. The AngelList Order is reminiscent of the CommunityLend Order in that it sets out a detailed set of conditions respecting the operation of the funding platform and the process that AngelList must undertake with investors.

These provisions include detailed descriptions of each of the service areas to be delivered on the platform and how the platform will operate generally. Allowable services include "Public Services"; "Connection Services"; "Recruiting Services"; "Restricted Services"; "Syndicate Services"; a Professional Investor Program and an Approved Incubator Programs that include University of Toronto Rotman School of Management's Creative Destruction Lab and NEXT Canada.

The AngelList Order also contains several conditions respecting how accredited investors can participate on the platform (for example, "Lead Investors", "Permitted Clients", "Ontario Quality Investors" and "Credible Investors"); information that must be retained with respect to accredited investors; disclosure that must be given to accredited investors (for example, prescribed risk disclosure); the process for verifying accreditor investor status; the role of "Lead Investors"; specific suitability criteria for accredited investors (for example, previous venture capital experience); identity verification and the use of algorithm scores to rate investors. The AngelList Order also contains several conditions for types of issuers that can sell securities on the platform (for example, "Eligible Canadian Startups", "Venture Capital Funds", "Private Syndicates" and "SPEs").

The AngelList Order, CommunityLend Order and the conditions of registration imposed on Loop Securities and Vault Circle provide insight into how fintech companies in the online lending space will be required to operate in Canada in the future.