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Public Company Disclosure & Corporate Governance

CONTINUOUS DISCLOSURE

Canadian Securities Administrators Announce New Insider Reporting Regime

On January 22, 2010, the Canadian Securities Administrators (CSA) published an advanced notice of the adoption of a new insider reporting regime that aims to harmonize, simplify and streamline how insiders report their operations to the public. The CSA has elected to consolidate the main reporting requirements into one single regulation, National Instrument 55-104 *Insider Reporting Requirements and Exemptions* (NI 55-104). The new regulation will establish consistent insider reporting requirements applicable in all CSA jurisdictions, except in Ontario, where the principal insider reporting requirements will remain under the Ontario *Securities Act*.

The comment period for the proposed materials submitted by the CSA expired on March 19, 2009, and entry into force of NI 55-104 is scheduled to take place on April 30, 2010. This article highlights several of the upcoming changes.

Introduction of the Term of “Reporting Insider” and Reduction of the Numbers of Insiders Required to File Insiders’ Reports

The CSA adopted in NI 55-104 a principled approach to insider reporting by significantly narrowing the class of insiders required to file reports, and by introducing the novel term of “reporting insider.” The Instrument enumerates a list of insiders who typically receive or have access to information as to material facts or material changes concerning the reporting issuer before these facts or changes are disclosed, and insiders who exercise significant power or influence over the business, operations, capital or development of the reporting issuer. Such insiders include CEOs, CFOs and COOs (of the issuer and of any major subsidiary), directors and significant shareholders of the reporting issuer (actual or based on post-conversion beneficial ownership), among others. The novelty of the Instrument rests in the addition of a “basket” provision, which seeks to include all insiders who may not be enumerated (and may not in some cases be “insiders” under securities legislation), but who satisfy the two criteria of access to material information and influence over the reporting issuer. Finally, insiders who are enumerated but who do not satisfy the two criteria may avail themselves of an exemption pursuant to the Instrument.

The CSA also modified the definition of “major subsidiary,” increasing the percentage threshold for a company to qualify as a subsidiary of an issuer from 20 per cent of assets and revenues to 30 per cent of assets and revenues of such issuer. This increase narrows significantly the class of insiders required to file reports.

Concept of Post-Conversion Beneficial Ownership

The CSA has adopted the concept of “significant shareholder based on post-conversion beneficial ownership,” which is intended to prevent persons from circumventing disclosure threshold by holding convertible securities such as options or warrants, rather than the underlying securities directly. Hence, a person or a company will qualify as the beneficial owner of securities at a given date if such person or company holds a security convertible in the underlying security within 60 days of that given date. Consequently, the new concept of “significant shareholder,” which leads to qualification as a reporting insider, will include any holder of securities held but not yet converted, and which would amount to 10 per cent of the voting rights attached to all of the issuer’s outstanding voting securities after conversion.

Reporting Deadline Reduced from 10 Days to Five

Although the 10-day delay for filing initial insider reports is maintained, NI 55-104 provides for a shortened filing period of five days for subsequent reports disclosing a change in the beneficial ownership of securities of the reporting issuer, as well as a change in the

reporting insider’s interest in a related financial instrument involving a security of the reporting issuer. The CSA supplemented its December 2008 proposal with a six-month transition period following the entry into force of the Instrument, in order to provide insiders and issuers adequate time to familiarize themselves with the new accelerated reporting requirements.

Impact of NI 55-104 on Derivatives Transactions

In its Companion Policy to NI 55-104, the CSA explains that the Instrument purports to put an end to the uncertainty as to whether certain derivative instruments constitute securities, and consequently whether such instruments should be the object of insider reporting requirements. This was done by subsuming the notion of derivative instruments under the notion of “related financial instrument,” targeted by the Instrument’s primary and supplemental insider reporting requirements. Consequently, reporting requirements previously contained in the Multilateral Instrument 55-103 *Insider Reporting for Certain Derivatives Transactions (Equity Monetization)* have been integrated into the Instrument.

Clarification of Stock-Based Reporting Requirements, Related Exemption and Introduction of the Issuer Grant Report

The CSA also simplified and created more consistency among the insider reporting requirements relating to certain stock-based compensation arrangements. The new definition of “compensation arrangements” in NI 55-104 includes “options, stock appreciation rights, phantom shares, restricted shares or restricted

share units, deferred share units, performance units or performance shares, stock, stock dividends, warrants, convertible securities, or similar instruments.” By regrouping all of these stock-based compensation arrangements in a single definition, the reporting requirements will apply consistently to all stock-based compensation arrangements.

The CSA hence establishes an exemption from direct reporting by certain insiders (directors and officers of the reporting issuer and of the important subsidiary of the reporting issuer) for securities received under compensation arrangements, provided that the issuer has previously disclosed the existence and material terms of such compensation agreement on SEDAR and, in the case of acquisition of securities, provided that the reporting issuer has previously filed an issuer grant report on SEDI.

In addition, to benefit from the exemption, the director or officer must have complied with the provisions regarding alternative reporting by filing an insider report disclosing each acquisition and disposition of securities under a compensation arrangements not previously disclosed. As a result, the insider would be relieved from the obligation to file an insider report in respect of the grant by the regular deadline, and instead be allowed to file an alternative activity or status report on an annual basis.

This article was previously published as a [Legal Update](#).

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CSA Releases Guidance on Forward-Looking Information Requirements

On November 20, 2009, the Canadian Securities Administrators (CSA) released CSA Staff Notice 51-330, which provides guidance on the forward-looking information (FLI) requirements contained in National Instrument 51-102 *Continuous Disclosure Obligations* (the Rule). The guidance results from recent continuous disclosure reviews conducted by the CSA. The Staff Notice addresses the identification of FLI; disclosure regarding material risk factors and material factors or assumptions; updating practices; explanation of purpose of, and cautionary language related to, financial outlook or future-oriented financial information (FOFI); disclosure regarding goals or targets; and impact of the transition to International Financial Reporting Standards (IFRS) on FOFI or financial outlooks.

The CSA noted that many issuers identified material FLI solely through a cautionary paragraph at the beginning or end of a disclosure document. Although the Rule does not prescribe the manner in which reporting issuers must identify FLI, the Companion Policy to the Rule provides guidance that the disclosure should be presented in a manner that allows an investor to be able to readily identify the material FLI. According to the CSA, when identifying FLI, reporting issuers should avoid: (i) indicating that forward-looking statements are often, but not always, identified by words such as “believes,” “may,” “likely” and “plans”; (ii) indicating that all statements, other than statements of historical fact, are forward-looking statements; and (iii) stating that a document contains FLI when, to the reporting issuer’s knowledge, it does not. Instead, the CSA encourages reporting issuers to specifically identify the nature of the material FLI included in the document.

The Rule requires reporting issuers that disclose material FLI to include disclosure that identifies material risk factors that could cause actual results to differ materially from the FLI. The CSA advises that while reporting issuers are not precluded from incorporating by reference material risk factors and material factors or assumptions contained in other documents, when doing so, they should consider whether it enables the reader to readily identify the material risk factors and material factors or assumptions associated with the material FLI. Reporting issuers should avoid “boilerplate” disclosure and should present the disclosure in a user-friendly manner. In addition to the disclosure of material risk factors and material factors or assumptions,

when disclosing FOFI or a financial outlook, reporting issuers should disclose the purpose of the information and caution readers that the information may not be appropriate for other purposes.

The Staff Notice reminds reporting issuers that they are required to update previously disclosed FLI in certain circumstances and that they should ensure that their policy for updating FLI is in compliance with the Rule. In addition, reporting issuers are generally expected to disclose a target or goal only if it is “possible” to achieve. Finally, since the Rule requires that FOFI or financial outlooks be based on the accounting policies that the issuer expects to use to prepare its historical financial statements for the period covered by the FOFI or the financial outlook, reporting issuers are reminded of the potential impact of the transition to IFRS.

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Highlights from the OSC's Annual Corporate Finance Branch Report

The Corporate Finance Branch of the Ontario Securities Commission (OSC) recently released its [annual report](#) for 2009. The report reviews a number of the actions taken and issues considered by the Corporate Finance Branch over the last year, including certain actions taken in response to the market downturn, a summary of its continuous disclosure review activities, the pending transition to IFRS, and a review of certain significant decisions of the OSC on merger and acquisition matters over the past year. This article highlights a selection of topics found in the report.

Continuous Disclosure Review

A key theme of the OSC Staff's continuous disclosure review efforts this past year is the identification of the failure of several issuers to move beyond "boilerplate" and generic language when specific disclosure is in fact required. It is often mentioned that language for specific disclosure requirements (*i.e.*, related party disclosure; liquidity and capital resources disclosure) is simply lifted from an issuer's financial statements. OSC Staff are clearly looking for more specific and directed language in response to disclosure requirements.

Pension Plans

Pension plans, specifically of the defined benefit plan variety, appear to remain on the forefront of the OSC's issue list. It was notable that OSC Staff required most of the issuers that had their continuous disclosure documents reviewed to

provide greater disclosure in their MD&A as to how pension funding obligations were affecting their financial position and any risks associated with funding the pension plans. Not surprisingly, if an issuer received any temporary solvency funding relief, the impact of such relief should be fully outlined in their MD&A.

ABCP

As a result of the 2009 restructuring of the non-bank asset-backed commercial paper market in Canada, new notes were issued with maturities that coincide with the terms of the underlying assets. In the first two quarters of 2009, OSC Staff scrutinized the filings of significant holders of the new notes. Generally, the OSC was dissatisfied with the amount and detail of the disclosure provided by these significant holders of notes. Specifically, OSC Staff was concerned with:

- (a) insufficient disclosure regarding assumptions and criteria used when determining fair market value for illiquid notes;
- (b) improperly classifying new notes as "current assets" on the balance sheet (without actually clarifying *how* the new notes ought to be classified);
- (c) not considering all market data in valuation procedure; and
- (d) little mention of changes in material assumptions and how this affects fair market value over different periods of time.

The above comments should be considered by all issuers holding the new ABCP notes.

Mergers & Acquisitions

On M&A matters, OSC Staff included a brief analysis of some recent developments.

Firstly, commentary is provided regarding potential acquirors that modify their bid in a less favourable way, or that unilaterally withdraw a bid. This commentary was expounded upon when, on December 18, 2009, the CSA issued [Staff Notice 62-305](#), which expressed detailed concern about these types of actions. OSC Staff believe that these actions are inconsistent with the take-over bid framework, and have given notice that they will be scrutinizing such behaviour very closely.

The Corporate Finance Branch Report also reviews four key M&A decisions of the Commission from 2009. This review provides brief insights into OSC Staff's analysis of some of the issues raised by each decision.

- *Re HudBay Minerals Inc:* the Commission overruled the TSX's decision to not seek shareholder approval on a highly dilutive share issuance by an acquiror because the Commission believed that without such approval, the quality of the marketplace would be adversely affected and would be contrary to the public interest. In short, the Commission felt that the decision was not 'reasonable,' and ultimately ordered that shareholder approval be obtained by the acquiror.
- *InterRent Real Estate Investment Trust:* using the 'reasonable' standard of review used in *HudBay*, the Commission upheld the TSX's decision not to require shareholder approval for a private placement by InterRent. Unlike in the *HudBay* decision, the TSX was more thorough and detailed in its analysis and decision in this case.
- *Re JLL Patheon Holding LLC:* the Commission dismissed an application, with important conditions, by a special committee of directors of Patheon Inc. that alleged that certain shareholders who were "joint actors" with the bidder were receiving special treatment under a take-over bid in being permitted, at their option, to retain equity in the successor company. The Commission took steps to enforce the equal treatment of all Patheon shareholders.
- *Pala Investment Holdings Inc:* the Commission dismissed Pala's application to cease trade a second shareholder's rights plan adopted by Neo Material Technologies Inc, and approved by its shareholders in the face of the take-over bid of which the shareholders were fully informed.

