DAVIES

Governance Insights

September 2022

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Davies Governance Insights analyzes the top issues facing Canadian public companies today. The report offers expert insights and practical guidance to help boards stay ahead of these challenges and position their organizations for success.

In today's fast-changing governance landscape, this edition also marks the introduction of our new, semi-annual publication format, designed to capture the most relevant and up-to-date developments to guide boards in formulating their strategies. As always, future editions will offer insights on traditional governance topics that we've explored in depth over the years as well as new trends that may emerge.

For more information on any of the topics discussed in the report or to explore how we can bring value to your board and governance teams, contact one of our experts listed under Key Contacts at the end of the report.

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Overview

As the corporate world continues to inch closer to resuming normal business operations, today's business leaders face an increasingly complex set of challenges that are anything but normal. World-changing events of the past two years, including the COVID-19 crisis, have radically altered the corporate landscape and forced many companies to reshape their business models.

Emerging from the pandemic, companies are facing an uncertain economic and geopolitical climate, heightened public scrutiny and ever-expanding demands from various stakeholder groups. The focus on environmental, social and governance issues continues to ramp up as investors, regulators and other stakeholders put pressure on companies to act. In the past year, corporate accountability for climate change reached a watershed moment as regulators in both Canada and the United States moved toward mandatory climate disclosure requirements. At the same time, social justice movements that focused on diversity and equality spotlighted the need for urgent action at the corporate level. These changes have exemplified the shift to a more integrated model of corporate governance that considers a wider range of stakeholders, including employees, customers, communities and the environment.

Against this backdrop, we explore in this edition of *Davies Governance Insights* the following issues that will require boards' focus for the remainder of 2022 and beyond. In keeping with the theme of change, this edition is the first in our new, twice-yearly publication schedule, designed to capture the most relevant and up-to-date developments of importance to corporate boards.

- With the COVID-19 pandemic dominating headlines since March 2020, many significant regulatory and judicial changes may not have received the attention they deserve. We detail some of these developments and what they mean for organizations in **Chapter 1: 10 Regulatory and Judicial Developments That GCs and Boards Need to Know.**
- In the post-pandemic economic climate, companies facing difficult financial decisions may struggle to meet the expectations of shareholders or other stakeholders. We provide an overview of the oppression remedy, including how oppression claims may arise and how boards can protect themselves, in **Chapter 2: Bulletproofing Your Board Against Oppression Claims.**
- Recent data suggest that tenure for chief executive officers (CEOs) is declining, while CEO turnover is increasing. We review recent trends in CEO departures, set out best practices for ongoing planning and outline core disclosure issues that boards should keep top of mind in **Chapter 3: CEO Succession Trends and Best Practices.**
- As of August 31, 2022, federally incorporated public companies are subject to true majority voting for uncontested director elections. We answer common questions and set out steps that corporations can take to ensure a smooth transition in **Chapter 4: True Majority Voting for CBCA Public Companies: Is Your Board Ready?**
- While the arrival of mandatory climate disclosure in Canada is inevitable, exactly what that will entail remains to be seen. We compare the Canadian Securities Administrators' proposed approach with the more stringent rules proposed by the U.S. Securities and Exchange Commission and other international organizations in **Chapter 5: Competing Frameworks: Mandatory Climate Disclosure Is (Almost) Here.**

CHAPTER 01

10 Regulatory and Judicial Developments That GCs and Boards Need to Know

Keeping up with Canada's constantly shifting regulatory and judicial landscape can be a challenge for general counsel (GCs) and boards of directors, but the importance of doing so cannot be understated. No public company wants to be the test case for a securities commission or a court applying new rules or guidance. Understanding recent legal developments and their underlying policy issues is critical to anticipating and navigating potentially problematic circumstances before they actually become problems, as well as to ensuring the fulfillment of GCs' and boards' evolving duties and responsibilities, including with respect to risk oversight. Several notable developments have been precipitated or accelerated by the COVID-19 pandemic, which has dominated headlines since March 2020. However, the majority of recent regulatory and judicial changes are largely unrelated to COVID-19 and, for that reason alone, may not have received the attention they deserve. In this chapter, we explore 10 important developments that GCs and boards need to know.

1 | The Long and the Short of It: Activist Short Selling

In December 2020, the Canadian Securities Administrators (CSA) published CSA Consultation Paper 25-403 – *Activist Short Selling* to facilitate discussion of concerns related to activist short selling and its potential market impact, a move that proved prescient given the GameStop saga that unfolded in the United States in January and February 2021. At its simplest, short selling involves selling securities that one does not own. Typically, a short seller borrows securities and then sells them on the open market with the expectation they will decline in value. The short seller then purchases securities at a lower price and returns them to the lender, thereby realizing a profit. Activist short selling refers to instances in which a short seller publicly shares information or analysis that is likely to have a negative effect on the price of the securities being "shorted."

Short selling is a legitimate investment strategy that provides several benefits to the capital markets. Activist short selling can be positive or negative depending on the accuracy of the information that a short seller disseminates. At one end of the spectrum are short sellers that conduct extensive research and analysis, and provide accurate information to the market explaining why an issuer's securities may be overvalued. At the other end, however, are so-called short-and-distort campaigns in which unscrupulous short sellers deliberately disseminate false or misleading information in order to drive down the price of an issuer's securities to the detriment of the issuer, its securityholders and the capital markets as a whole. Many campaigns fall somewhere in the middle, which has prompted the CSA to explore whether additional regulation is required. For further details regarding activist short selling and the related issues currently under review by the CSA, see our comment letter.

KEY TAKEAWAYS

– **Regulators are taking abusive short selling seriously.** Issuers that find themselves subject to short-and-distort campaigns may find CSA staff receptive to their concerns, as regulators may be increasingly inclined to take enforcement action either in anticipation of new rules or as a means of demonstrating that the current rules are adequate and effective.

– **Victims of abusive campaigns may receive self-help tools.** Market participants should prepare for the possibility that the CSA will give issuers and securityholders a private right of action, which could curb victims' reliance on regulators and deter short sellers from deliberately disseminating misleading information.

– **Short sellers may be required to provide enhanced disclosure.** The CSA is considering whether to require short sellers to provide disclosure with respect to their short positions. In this regard, regulators may revisit whether disclosure of derivatives in early warning and alternative monthly reporting remains adequate or should be expanded.

2 | Time to Reconcile: Non-GAAP and Other Financial Measures Disclosure

Nearly three years after the CSA first published National Instrument 52-112 – *Non-GAAP and Other Financial Measures Disclosure* (NI 52-112) for comment, it came into force on August 25, 2021. Whereas the CSA has historically provided guidance about appropriate and inappropriate disclosure of financial measures, the new requirements in NI 52-112 are prescriptive. With few exceptions, the rules apply where a Canadian reporting issuer discloses a "specified financial measure," of which there are five distinct categories, in a public document (including on its website and social media). Depending on the category into which the specified financial measure falls, issuers need to comply with strict and often complex disclosure requirements. For non-GAAP measures, these include presenting the most directly comparable GAAP measure with equal or more prominence, explaining the measure's composition and providing a quantitative reconciliation to the most comparable GAAP measure. For a breakdown of the different specified financial measures and corresponding disclosure, read our bulletin *Mind the GAAP: Don't Get Tripped Up by the New Financial Measure Disclosure Requirements*.

KEY TAKEAWAY

Enhanced consistency, reduced flexibility. Although the new rules may provide clarity for investors that want to understand the "how" and the "why" behind the numbers, the trade-off is a fairly rigid regime of prescribed disclosure that requires issuers to dedicate additional time and resources to ensure compliance.

3 | Major(ity) Changes: Recent CBCA Amendments

A suite of amendments to the *Canada Business Corporations Act* (CBCA) enacted under Bill C-25 came into force on August 31, 2022, including the long-awaited implementation of true majority voting for uncontested director elections for public companies (also referred to as "mandatory," "compulsory" or "binding" majority voting).

In prior editions of *Davies Governance Insights*, we discuss the full scope of the amendments contemplated in Bill C-25, with a deep dive into the diversity disclosure requirements (which are already in force) and our preliminary thoughts on the majority voting regime. Here, we provide an overview of the changes that came into force on August 31, 2022, and in Chapter 4, we provide key considerations for CBCA public company boards to prepare for true majority voting in advance of their next director election.

Prior to August 31, CBCA public company director elections were decided by plurality voting. Shareholders were presented with only two options when casting their votes for a director nominee (“for” or “withhold”) such that, in an uncontested election, a director nominee could have been elected with only a single “for” vote, regardless of the number of votes withheld. The amendments to the CBCA, in the case of an uncontested meeting, now require shareholders of federal public companies to vote “for” or “against” each director nominee and also require each director nominee to receive a majority (i.e., at least 50% + 1) of “for” votes to be elected as a matter of law. While a simple majority is the default voting threshold under the new regime, the rule permits issuers to mandate a higher threshold; however, we do not expect many issuers to avail themselves of this option. The statutory plurality regime continues to apply in contested board elections for public companies (i.e., where there are more nominees than seats available on the board).

For Canadian public companies listed on the Toronto Stock Exchange (TSX), the impact of statutory majority voting should be lessened in light of the existing majority voting standard that applies to TSX-listed issuers. Under the current TSX rules, all listed issuers other than majority-controlled corporations must have a majority voting policy and disclose the results of that vote. In an uncontested election, the TSX requires that each director receive in their favour at least a majority (50% + 1) of the votes cast, failing which the director (although elected as a matter of law under the applicable corporate statute) is required to submit a resignation for acceptance by the board. The board must then accept the resignation within 90 days of the meeting unless there are “exceptional circumstances” that warrant the director remaining on the board.

Under the new CBCA rules, following the failure of a nominee director to receive the requisite majority support, a board is prohibited from relying on its corporate law right to fill the vacancy by appointing the director to the board after the meeting, except in two limited circumstances: first, if that director is needed on the board to satisfy CBCA (not securities law) independence requirements and, second, if that director is needed to satisfy CBCA Canadian residency requirements. By contrast, the “special circumstances” in which the TSX will permit a board to refuse the resignation of a director are broader in principle and may include cases in which the director’s resignation would result in the issuer not complying with corporate or securities laws or commercial agreements, or in which the subject director is a member of a key active special committee; these cases are, however, case-specific and expected to meet a high threshold.

Thus, even for a TSX-listed federal corporation subject to the exchange’s current majority voting rules, CBCA statutory majority voting means real change to the election process. The CBCA amendments of course apply to all federal public companies, including those listed on the TSX Venture Exchange (TSXV), which currently does not impose a majority voting standard (an omission intended to avoid undue governance burdens on such issuers). For non-TSX listed federal issuers, the CBCA changes may represent a significant departure from the governance regimes under which they have been operating. This may put pressure on boards of TSXV-listed issuers to pay closer attention to their governance practices relating to the identification, selection, nomination and election of directors. And although the new rule contemplates that the regulations may from time to time exempt certain classes of public companies from the majority voting requirement, no such exemptions are currently provided.

The following changes to the CBCA also came into force on August 31:

- **Appointment rights.** Prior to August 31, directors could appoint additional members to the board between meetings only if permitted under the corporation's articles. As of August 31, the statutory default reversed: a board now has the ability to appoint directors unless the articles remove that power.
- **Deadline to submit shareholder proposals.** Prior to August 31, a shareholder proposal had to be submitted to a CBCA corporation at least 90 days before the anniversary date of the notice of meeting issued for the immediately prior annual meeting. Under the new rule, a proposal must be delivered within the 60-day period that begins on the 150th day before the anniversary of the previous annual meeting. For issuers that customarily hold their meetings during the spring proxy season, this change means that shareholders should have a later outside date by which their proposal for an upcoming meeting must be submitted. Because proposals may only be submitted within a 60-day period, however, shareholders are effectively prevented from making early submissions and now need to pay close attention not only to the date when the window for submission closes but also to the date when it opens.

We also note that other CBCA amendments have been adopted but are yet to be proclaimed in force:

- **Notice-and-access.** Not yet in force are CBCA amendments to allow federal public companies that meet the requirements of, and are using, notice-and-access under National Instrument 51-102 – *Continuous Disclosure Obligations* and National Instrument 54-101 – *Communication with Beneficial Owners of Securities of a Reporting Issuer* to make proxy-related materials and annual financial statements available under that notice-and-access regime without seeking investors' prior written consent or exemptive relief under the CBCA. CBCA corporations that would like to use notice-and-access in the interim period may apply for an exemption.
- **Bill C-97 (additional disclosure requirements).** Other amendments announced in March 2019 (Bill C-97) have not yet been proclaimed in force. These changes include a requirement for certain CBCA public corporations to disclose to shareholders their approach to remuneration and to hold annual non-binding shareholder say-on-pay votes. The amendments will also impose new disclosure requirements applicable to certain CBCA corporations regarding diversity, the well-being of companies' employees, retirees and pensioners, and the clawback of director and officer compensation. We discuss these amendments in the 2019 edition of *Davies Governance Insights*.

KEY TAKEAWAYS

- **True majority voting applies to CBCA public companies.** As of August 31, 2022, in an uncontested election for the directors of a federally incorporated corporation, a director will not be elected as a matter of law unless that director receives a majority of the votes cast in the director's favour. In Chapter 4, we provide key considerations for CBCA public company boards to prepare for true majority voting in advance of their next director election.
- **Other CBCA amendments yet to be proclaimed in force.** Federal public issuers and their boards should continue to keep on their radars the forthcoming changes to the CBCA, including the ability to use notice-and-access and further disclosure obligations.

4 | Not-so-Special Committees: *Re ESW Capital, LLC*

In February 2021, the Ontario Securities Commission (OSC) weighed in on a battle over the governance, operations and strategic direction and control of TSX-listed Optiva Inc., which raged between its three dominant shareholders for over a year before a peace was ultimately brokered.

In July 2020, 28% shareholder ESW Capital, LLC announced its intention to make an offer to acquire all of Optiva's outstanding subordinate voting shares for C$60 per share in cash, which represented a 122% premium to the then-20-day volume-weighted average market price. The same day, EdgePoint Investment Group Inc., which held 18.1%, announced that it did not intend to tender its shares to the ESW offer and had no interest in pursuing discussions with ESW regarding a potential transaction. Maple Rock Capital Partners Inc., which held 22.4%, made a similar announcement the following day. Optiva also adopted a tactical shareholder rights plan, which was narrowly approved by a 52% vote of Optiva's shareholders and which prevented ESW's bid from proceeding absent a waiver by Optiva's board.

Because ESW already held 28% of the outstanding shares, more than half of the remaining shares (approximately 36%) had to be tendered to its offer in order to satisfy the minimum tender requirement in National Instrument 62-104 – *Take-Over Bids and Issuer Bids*. This was mathematically impossible if both Maple Rock and EdgePoint refused to tender. Accordingly, ESW applied to the OSC for exemptive relief to allow it to exclude the shares held by Maple Rock and EdgePoint from the minimum tender requirement. In refusing to grant relief, the OSC emphasized the importance of a predictable takeover bid regime and stated that it would not intervene absent exceptional circumstances or clear improper or abusive conduct by the target, bidder or control block holders that undermined minority shareholder choice. In the OSC's view, no such exceptional circumstances or abusive conduct existed here.

The implications of the *ESW* decision are discussed in our bulletin *Between a Block and a Hard Place: ESW Capital Denied Relief in Proposed Bid for Optiva*. From a governance perspective, it is important to consider the impact of this decision on independent special committees. For years, Canadian securities regulators have taken a firm stance with respect to the high standards to which special committees are expected to adhere in connection with insider bids and other material conflict of interest transactions. In *Re Sears Canada Inc*, the OSC highlighted the role of a special committee as "a critical component of the protections afforded to minority shareholders." In *Re Magna International Inc (Magna)*, the OSC noted that directors "must ensure that the process followed appropriately manages the conflicts of interest of all parties." In many ways, the *Magna* decision inspired the publication of Multilateral CSA Staff Notice 61-302 – *Staff Review and Commentary on Multilateral Instrument 61-101 Protection of Minority Security Holders in Special Transactions* (SN 61-302), which has become an unofficial instruction manual for managing the risks inherent in material conflict of interest transactions, including the importance of a proper special committee process.

In *ESW*, the OSC had some reservations concerning the conduct of Optiva's special committee charged with evaluating ESW's bid. Notably, the only two members of the special committee were both nominees of Maple Rock; the special committee adopted a tactical shareholder rights plan with a 30% trigger as opposed to a customary 20% trigger, effectively enabling Maple Rock and EdgePoint, but not ESW, to continue accumulating shares; and there was no evidence that the special committee explored strategic alternatives or commenced an auction process (even though rights plans are typically instituted for these purposes). The OSC went so far as to state that Optiva's special committee's initial efforts "could fairly be described as being tactical," and acknowledged that Optiva had taken steps to reduce ESW's control and influence.

KEY TAKEAWAYS

- **Expectations for special committees remain high.** The OSC appeared unimpressed with the conduct of Optiva's special committee. However, it concluded that the need for predictability in Canada's new takeover bid regime and the importance of avoiding potential coercion of minority shareholders outweighed the special committee's less-than-optimal approach. Special committees that comport themselves as Optiva's special committee did in *ESW* should brace for harsher criticism and, potentially, a different outcome.
- **Guidance for special committees may become law in due course.** The Capital Markets Modernization Taskforce (Taskforce) has recommended codifying the best practices for special committees set out in SN 61-302 and mandating special committees for all material conflict of interest transactions, a recommendation on which Ontario's Ministry of Finance (Ministry) consulted further in connection with the publication of the draft *Capital Markets Act* (CMA). If the recommendation is adopted, it would transform guidance for material conflict of interest transactions into a prescribed set of rules to which issuers involved in these transactions would have to adhere.

5 | A Mixed Bag: Capital Markets Modernization Taskforce Report and Draft *Capital Markets Act*

In February 2020, the Ontario government formed the Taskforce, whose mandate was to review and modernize Ontario's capital markets regulations. Following the publication of its initial consultation report in July 2020 and the receipt of more than 130 comment letters, in January 2021, the Taskforce published its final report containing 74 recommendations. As discussed in our comment letter on the Taskforce's initial consultation, several recommendations represented much-needed updates (a number of which were initiatives the CSA had been pursuing for some time) to a securities regulatory framework that had not been formally reviewed since 2003. These included facilitating electronic delivery of documents and providing issuers with the flexibility to gauge interest from institutional accredited investors before formally commencing securities offerings. Other recommendations, such as expanding the OSC's mandate to include fostering capital formation and competition in the markets, were quite controversial.

In October 2021, the Ministry published the CMA for stakeholder consultation on the Taskforce's recommendation. If enacted, the CMA would replace Ontario's *Securities Act*. For the reasons discussed in our comment letter (including that the CMA would unduly increase regulatory burden for various stakeholders and generate significant market uncertainty), we have suggested that the Ministry instead amend Ontario's existing securities legislation – as it has done many times before – to incorporate certain positive changes the CMA contemplates.

KEY TAKEAWAYS

- **Further burden-reducing measures are en route.** Several of the Taskforce's recommendations are geared toward making life easier for issuers. These include allowing issuers to consolidate their financial statements, management's discussion and analysis (MD&A) and annual information form into a single document, to report semi-annually rather than quarterly and to raise smaller amounts of capital without a prospectus, all of which the CSA is actively considering. Given the regulatory focus on burden-reducing initiatives in recent years, other similar changes are likely coming soon.

- **Issuers may get to know who their beneficial shareholders are.** The Taskforce has proposed eliminating non-objecting beneficial owner and objecting beneficial owner statuses, which would allow issuers to access a complete list of their securityholders and do away with the anonymity that objecting beneficial owner status currently provides. If adopted, this could have profound implications for issuers' shareholder engagement strategies in the future.

- **New, but not necessarily improved.** Market participants continue to await the Ministry's next steps with respect to the CMA. If it is ultimately enacted, stakeholders should brace for a fairly lengthy, uncertain and costly transition period during which they will be forced to navigate a host of new and modified regulatory requirements.

6 | Let's Not Get Physical: Access Equals Delivery

In April 2022, the CSA published for comment proposed amendments to implement an access equals delivery model (AED model) for prospectuses, annual financial statements, interim financial reports and related MD&A for non-investment fund reporting issuers. Under the proposed AED model, delivery of a final prospectus and any amendment would be effective once it is filed on SEDAR and a news release is issued and filed indicating that the document is available electronically and that a paper or an electronic copy can be obtained upon request. A preliminary prospectus and any amendment would not require the issuance and filing of a news release, and the CSA is specifically seeking comment on whether a news release is necessary for the filing of financial statements and related MD&A.

The proposed amendments resulted from a public consultation the CSA undertook in early 2020 on the merits of an AED model for which a large majority of commenters, including Davies, expressed support. Although the CSA considered extending the AED model to other types of documents such as proxy-related materials, takeover bid circulars and issuer bid circulars, it determined that doing so with respect to documents that require immediate shareholder attention and participation could raise investor protection concerns and have a negative impact on shareholder engagement. For our views on the CSA's proposed AED model, please refer to our latest comment letter.

KEY TAKEAWAY

Slowly entering the digital age. An AED model would provide issuers with a more cost-effective, timely and environmentally friendly method of communicating information than physical delivery. However, the proposed AED model may not go far enough. For example, investors would be able to request paper copies of prospectuses, and those prospectuses would have to be sent within two business days. As a result, issuers may print numerous copies in advance as a precautionary measure, with substantially all of those printed copies never being used, undercutting some of the intended efficiencies and environmental benefits.

Under the proposed AED model, delivery of a final prospectus and any amendment would be effective once it is filed on SEDAR and a news release is issued and filed indicating that the document is available electronically and that a paper or an electronic copy can be obtained upon request.

7 | Fair Play: Fairness Opinions and Plans of Arrangement

Plans of arrangement are court-supervised processes that allow issuers to undertake a variety of transactions ranging from restructuring debt to privatizations. Procedurally, issuers first seek an interim order to "set the wheels in motion" and obtain conditional approval for the arrangement and related procedures, such as the securityholders' meeting, voting thresholds and dissent rights. Once securityholder approval is obtained, the issuer will seek a final order when the court will make its final determination as to whether or not the arrangement is "fair and reasonable."

Two recent decisions regarding plans of arrangement – both by Justice Koehnen of the Ontario Superior Court of Justice (Court) – have cast doubt on two widely held views: first, that a fairness opinion is always useful in demonstrating that a plan of arrangement is fair and reasonable and, second, that the interim fairness hearing is little more than a perfunctory step in advancing a plan of arrangement.

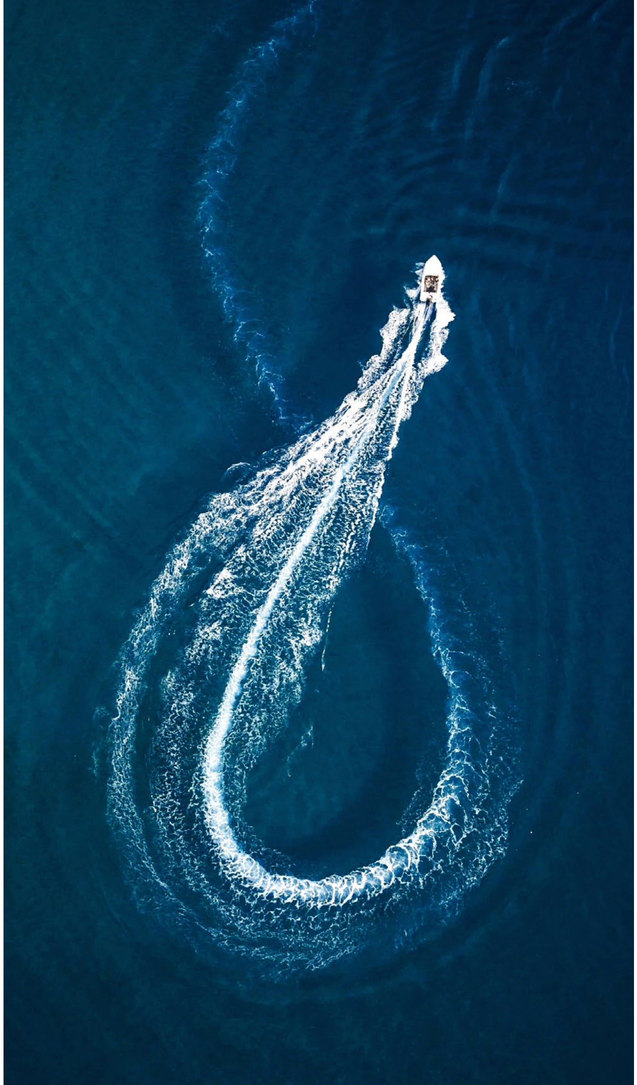
RE SHERRITT INTERNATIONAL CORPORATION

In *Re Sherritt International Corporation (Sherritt)*, the issuer applied for final approval of a plan of arrangement to restructure its debt. The arrangement was opposed by two unsecured creditors. Although the Court ultimately concluded that the arrangement was fair and reasonable, it identified issues with the fairness opinion that the issuer had obtained in support of the arrangement. The Court observed that fairness opinions are "often referred to with almost religious reverence as if they were the definitive answer to questions about fairness" and "are often invoked with veneration and treated like an all-powerful talisman that should resolve any questions about fairness," but that "[t]he power of a talisman, however, lies more in the faith of the believer than the substance of the object." The Court emphasized that the utility of a fairness opinion will be contingent on various factors, including the following:

- **The expertise of the author.** If the fairness opinion speaks to liquidation values and the author's primary area of expertise is M&A, the opinion may be devalued.
- **The author's independence from the issuer.** If the opinion is being provided by a bank with which the issuer has a close relationship, a court may be skeptical of the bank's conclusion with respect to the fairness of the transaction.
- **The extent to which the fairness opinion evidences the author's analysis and methodology.** Fairness opinions that show little or none of the author's methodology may be given little or even no weight by a court.
- **Whether the fairness opinion contemplates the appropriate stakeholders.** Corporations Canada's guidance provides that a fairness opinion should state that the arrangement is fair to each class of securityholders affected by the arrangement. If the opinion is only provided for the benefit of the issuer or a subset of its securityholders, a court may have concerns.

RE CANOPY RIVERS INC

A few months after the *Sherritt* decision, the Court provided guidance regarding its expectations for applications for an interim order in *Re Canopy Rivers Inc*. Although the purpose of an interim motion is not to assess substantive fairness, courts require certain information that will enable them to assess procedural matters such as the terms of the securityholders' meeting. In particular, issuers should identify their securityholder base (i.e., institutional versus retail), discuss the genesis of the transaction and explain why the proposed plan is fair. The Court reiterated that the mere presence of a fairness opinion is of little help given that the quality of these opinions varies widely. As in *Sherritt*, the Court had no reservations granting the order since the issuer ultimately addressed its concerns, but concluded that it would be helpful to raise the issue pre-emptively for future plans of arrangement.



KEY TAKEAWAYS

- **Courts are not rubber stamps.** Issuers and their counsel need to be prepared for courts to ask difficult questions at both the interim and the final hearings. Recycling generic precedent applications and facta that are not tailored to an issuer's unique circumstances and those of the proposed transaction may be met with more judicial scrutiny.

- **Not all fairness opinions are created equal.** Whether to obtain a fairness opinion for a transaction, and in what form, is a matter for an issuer's board of directors to decide. In certain cases, a short-form fairness opinion can be sufficient. However, in many circumstances, particularly those in which an issuer is relying heavily on the fairness opinion to demonstrate that the transaction is fair and reasonable, the issuer should strongly consider obtaining a long-form or a "hybrid" fairness opinion from a qualified, independent, subject-matter expert. This is particularly true for arrangements involving material conflicts of interest, which securities regulators continue to monitor and review on a real-time basis.

8 | No Immunity for Issuers: COVID-19 Disclosure

In February 2021, the CSA published CSA Staff Notice 51-362 – *Staff Review of COVID-19 Disclosures and Guide for Disclosure Improvements*, releasing the results of its review of issuers' continuous disclosure relating to the impact of COVID-19 on their respective businesses. Although CSA staff noted that most issuers reviewed were proactive in providing quality and detailed disclosure, several areas were noted as warranting improvement, including the following:

- Many issuers' MD&A did not include an adequate discussion of measures taken to reduce the impact of COVID-19, and did not disclose in detail issuers' ability to meet working capital requirements or to fund developmental activities and capital expenditures.
- With respect to financial statements, some issuers failed to adequately update their disclosure and assumptions impacted by COVID-19 in the context of testing impairments of goodwill and intangible assets, measuring fair value and estimating expected credit losses.
- In certain cases, CSA staff found issues with non-GAAP measures that were not adjusted for the impact of COVID-19, insufficient disclosure of the assumptions used to develop forward-looking information and overly promotional disclosure by some issuers in the biotech/pharma industry.

KEY TAKEAWAYS

- **There is no one-size-fits-all approach.** What is appropriate for one issuer may not be appropriate for another. Issuers are expected to be transparent and to provide meaningful, entity-specific disclosure that enables market participants to understand the impact of COVID-19 on their operations, financial condition, risks, trends and uncertainties. In many respects, CSA staff's guidance is a microcosm of the overarching trend in other areas, including ESG and cybersecurity, in which non-quantitative, boilerplate disclosure is coming under scrutiny and can potentially form the basis for litigation or enforcement action.
- **Regulators are continuing to monitor.** CSA staff is likely to continue to monitor the impact of COVID-19 on issuers' businesses. Given the publication of detailed guidance, regulators are unlikely to have much patience for non-compliance; issuers therefore need to be particularly vigilant regarding COVID-19-related disclosure in the future.

9 | Change Is in the Air: Climate-Related Disclosure

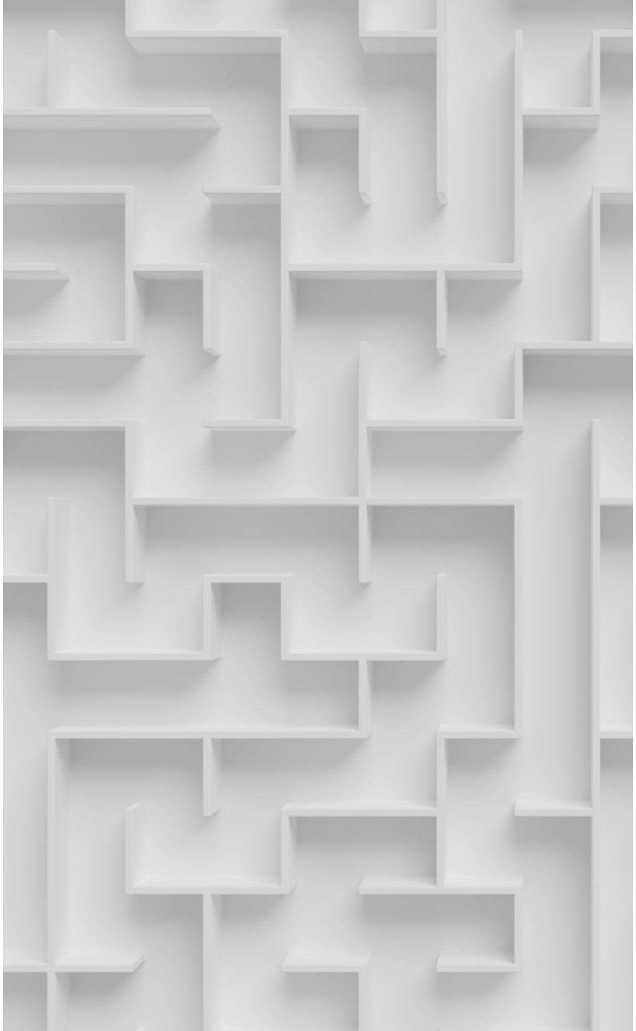
In October 2021, the CSA published proposed National Instrument 51-107 – *Disclosure of Climate-related Matters* (NI 51-107) for stakeholder consultation, which builds upon climate-related guidance published by CSA staff dating back to 2010. Despite the CSA's conclusion that issuers are generally providing more and better climate-related information than they did five years ago, that progress was not enough to allay the CSA's concerns that, in the absence of hard-and-fast rules, issuers' disclosure may not be complete, consistent and comparable.

As discussed in more detail in Chapter 5, NI 51-107 would require all reporting issuers to disclose climate-related information as it pertains to the four core elements of the Task Force on Climate-related Financial Disclosures (TCFD) recommendations:

- **Governance.** An issuer would have to describe the board's oversight of, and management's role in assessing and managing, climate-related risks and opportunities.
- **Strategy.** Where the information is material, an issuer would have to describe the climate-related risks and opportunities it has identified in the short, medium and long terms, as well as their impact on the issuer's businesses, strategy and financial planning.
- **Risk management.** An issuer would have to describe its processes for identifying, assessing and managing climate-related risks, and how those processes are integrated into the issuer's overall risk management.
- **Metrics and targets.** Where the information is material, an issuer would have to disclose the metrics and targets that it uses to assess and manage climate-related risks and opportunities. The CSA is also considering whether to mandate disclosure of Scope 1, Scope 2 and Scope 3 greenhouse gas emissions. Importantly, the CSA is not proposing to require disclosure of scenario analysis.

If adopted prior to December 31, 2022, these disclosure requirements will apply to non-venture issuers' annual filings for the financial year ending December 31, 2023 (i.e., the filings due in March 2024), and to venture issuers' annual filings for the financial year ending December 31, 2025 (i.e., the filings due in April 2026). For our recommendations on how the CSA can improve upon its proposed rules, see our comment letter.

If adopted prior to December 31, 2022, these disclosure requirements will apply to non-venture issuers' annual filings for the financial year ending December 31, 2023, and to venture issuers' annual filings for the financial year ending December 31, 2025.



In March 2022, the U.S. Securities and Exchange Commission (SEC) proposed its own rule changes to require climate-related disclosure. Although the SEC's proposal is also based on the TCFD recommendations, it differs from the CSA's version in several respects, which we discuss in detail in Chapter 5. As drafted, the SEC's new rules would not apply to Canadian issuers that rely on the multijurisdictional disclosure system (MJDS), the regime that enables eligible Canadian issuers to satisfy their U.S. reporting obligations and register securities in the United States by using documents prepared primarily in accordance with Canadian requirements. However, the SEC specifically sought comment on whether this is the right approach. As discussed in our comment letter, we believe that it is.

KEY TAKEAWAYS

- **Better late than never, but never late is better.** For many issuers, aligning climate-related disclosure practices, processes and procedures with the TCFD recommendations has been a multi-year endeavour. Issuers that have referenced other voluntary frameworks, such as the Global Reporting Initiative framework or the Sustainability Accounting Standards Board recommendations, will have to adjust in relatively short order. For issuers that have ignored climate-related disclosure altogether despite its ever-increasing importance to both regulators and investors, the inconvenient truth is that there may not be enough time to fully comply.
- **The SEC's impact.** Although MJDS issuers will be paying careful attention to whether the SEC reverses course and subjects them to U.S. requirements, all issuers should keep an eye on whether and to what extent the CSA tweaks its proposed approach to more closely align with the SEC's in the interests of moving toward a global baseline for climate-related disclosure.

10 | MAEday: Material Adverse Effect Clauses and Ordinary Course Covenants in M&A

For all of its ills, COVID-19 has provided some clarity on how material adverse effect (MAE) clauses and ordinary course covenants are likely to be interpreted by Canadian courts in the context of M&A transactions. Although the precise wording of MAE clauses varies, these clauses generally allow an acquirer to terminate an agreement if significant issues or events impacting the target's business arise between signing and closing, subject to specific negotiated carve-outs that are deemed not to constitute MAEs and that reinstate the acquirer's obligation to close the transaction. Relatedly, ordinary course covenants typically require the target to conduct its business during that interim period in the ordinary course and in a manner consistent with its past practice to ensure that the business that the acquirer receives on closing is substantially the same as the business that it agreed to buy when the agreement was signed.

FAIRSTONE FINANCIAL HOLDINGS INC V DUO BANK OF CANADA

In *Fairstone Financial Holdings Inc v Duo Bank of Canada (Fairstone)*, the Court considered whether the acquirer, Duo Bank of Canada, could terminate its agreement to buy Fairstone Financial Holdings Inc. on the basis that the pandemic constituted an MAE for Fairstone. Although the Court found that the pandemic had a material and adverse effect on Fairstone's business, the agreement stipulated that material effects caused by worldwide emergencies did not entitle Duo Bank to terminate the agreement. Although "pandemic" was not explicitly referenced in the carve-out, the Court concluded that it should interpret the provision broadly.

Duo Bank also argued that Fairstone failed to operate its business in the ordinary course. In rejecting this argument, the Court observed that the actions taken by Fairstone were in direct response to the pandemic and were customary across the industry in which Fairstone operated. The Court also noted that, even if Fairstone's conduct was not in the ordinary course of business, Duo Bank would have been obligated under the ordinary course covenant to provide consent for the alleged breaches because it would have been unreasonable for it not to do so. For additional details regarding the decision, refer to our bulletin *Buyer Beware: In Canada's First COVID-19 "Busted Deal" Decision, Court Finds That Duo Bank Cannot Terminate Its Acquisition of Fairstone Financial*.

CINEPLEX V CINEWORLD

Almost exactly one year after it released its decision in *Fairstone*, the Court was once again called upon to decide a pandemic-related case, this time between two movie theatre giants, in *Cineplex v Cineworld*. In December 2019, Cineworld Group plc agreed to purchase Cineplex Inc. for C$2.8 billion. Cineplex closed theatres beginning in March 2020 owing to COVID-19 and deferred payments to film studios and other suppliers while negotiating rent deferrals and abatements. Cineworld alleged that Cineplex had breached its covenant to operate in the ordinary course of business and terminated the agreement in June 2020. Notably, the agreement excluded effects caused by "outbreaks of illness" from the definition of MAE except where they had a materially disproportionate effect on Cineplex, which Cineworld did not allege at trial.

The Court followed *Fairstone* in concluding that Cineplex had not breached its ordinary course covenant, which required Cineplex to operate the business "consistent with past practice." The Court cited *Fairstone* for the proposition that "'consistent' does not mean identical; it means congruous, compatible and adhering to the same principles of thought and action." It found that Cineplex operated in the ordinary course when it deferred payments in response to theatre closures, actions that were consistent with the cash management tools that it had used to manage its liquidity in the past. The Court also noted that the exclusion of a pandemic from the definition of MAE effectively allocated the risk of the occurrence of the pandemic to Cineworld, a risk that could not be reallocated to Cineplex by a very narrow interpretation of the ordinary course covenant. The Court concluded that Cineworld had no basis to terminate the agreement and ordered it to pay Cineplex a staggering C$1.24 billion for lost synergies. It remains to be seen whether the Court's decision, particularly as it pertains to the unprecedented damages award, will withstand appellate scrutiny.

MAE provisions, including carve-outs that specify what does not constitute an MAE, and covenants delineating how the business must be managed until closing should not be boilerplate.

KEY TAKEAWAYS

- ***Caveat emptor* generally applies to MAEs.** Absent express language to the contrary, an acquirer of a business generally accepts forward-looking systemic risks associated with the business between signing and closing.
- **Every word in an agreement matters.** MAE provisions, including carve-outs that specify what does not constitute an MAE, and covenants delineating how the business must be managed until closing should not be boilerplate. Issuers and their advisers need to ensure that they negotiate these provisions to reflect the parties' desired risk allocation. These clauses must also be read and understood in the context of the agreement as a whole. If risks are allocated to the acquirer through carve-outs to the definition of MAE, it may be difficult to convince a court to interpret other provisions in a way that effectively reallocates that risk to the target.
- **Address potential conflicts before they become conflicts.** Some MAE provisions allocate the risk of a pandemic to one party and the risk of a change in law, which could include a lockdown order precipitated by a pandemic, to the other. Forward-thinking parties may wish to include language to clarify which party bears the risk when there may be multiple causes for an MAE.

Our Take: Staying a Step Ahead

Canadian securities regulators and courts are increasingly flexing their muscles to address perceived problems with market participants' conduct. From a regulatory perspective, this includes considering new rules to address activist short selling, clarifying COVID-19 disclosure expectations and codifying climate-related disclosure guidance. From a judicial perspective, courts are demanding more of issuers and their advisers regarding plans of arrangement. Issuers that understand where regulators and courts have drawn lines are well-positioned to avoid today's pitfalls. Issuers that understand *why* the lines have been drawn where they have been drawn are well-positioned to foresee and avoid tomorrow's pitfalls.

CHAPTER 02

Bulletproofing Your Board Against Oppression Claims

One of the principal roles of any board of directors is to make significant strategic decisions. In the post-pandemic economic climate, companies are facing numerous challenges, including cash shortages, executive turnover and a changing competitive landscape, all of which may force boards to rethink prior decisions and reposition the corporation's strategy. These changes in direction can have a significant financial impact and may exacerbate disagreements between the board and stakeholders over the best course of action for the company, potentially setting the stage for an oppression claim. In this chapter, we provide an overview of oppression claims, the situations in which they arise against public companies and the proactive steps that boards can take to protect themselves.

Oppression claims against public companies can impose significant financial, operational and reputational costs, both on the company itself and on its officers and directors personally. Boards need to consider these risks proactively, be aware of the types of situations that can result in oppression claims and consider best practices to prevent and defend against oppression claims.

The oppression remedy is an equitable remedy, which means courts tend to focus particularly on issues of fairness, even-handedness and other "equities" when evaluating the merits of an oppression claim. Given this context, public companies can take steps that may pre-empt or minimize the risk of oppression claims and provide useful defences if such claims are commenced. Beneficial governance strategies include

- considering best practices, including those set out below, with regard to internal governance, decision-making, minute-taking, public disclosure and information management; and
- anticipating possible areas of concern or sensitivity and ensuring that potential complainants are treated with respect and afforded appropriate consideration – even if that respect and consideration are not always reciprocated.

What Is an "Oppression Claim"?

In Canada, an oppression claim is a right of action created by federal and provincial corporate legislation. For federally incorporated companies, the oppression remedy is found in section 241 of the *Canada Business Corporations Act*. Analogous provisions appear in the corporate legislation of all provinces and territories. Similar regimes also exist under the laws of several foreign jurisdictions.

The party initiating an oppression claim is called a "complainant." As explained by the Supreme Court of Canada in *BCE Inc v 1976 Debentureholders* – a 2008 decision that remains the leading case on the oppression remedy – a complainant must prove that

- the complainant had a reasonable expectation with respect to the management or governance of the corporation that was breached by the corporation and/or its directors; and
- the breach was oppressive, unfairly prejudicial to or unfairly disregarded the interests of the complainant, being any securityholder, creditor, director or officer of the corporation.

Although complainants are usually minority shareholders, they can also include creditors, directors or officers.

A court has latitude to grant a wide range of remedies if it finds that the complainant has successfully established oppression. These remedies include awarding compensation, ordering the issuance or exchange of securities, seating or unseating directors, setting aside transactions or ordering an investigation.

Many oppression claims brought against public companies and their boards in Canada have been unsuccessful, partly because of the business judgment rule – according to which courts avoid second-guessing bona fide business decisions of corporate boards. Nevertheless, oppression claims – even if ultimately unsuccessful – can be time-consuming and resource-intensive, and can have significantly adverse repercussions for a company while such claims are ongoing. Oppression claims can lead to significant legal expense, cause stress and distraction for senior management and directors, overshadow positive business news and depress a company's stock price.

Facing Oppression Claims

In recent years, situations giving rise to oppression claims against public companies have included the following:

- transactions that dilute the interests of key shareholders and/or negatively affect the company's credit ratings (thereby depressing the value of issued debt);
- transformative commercial transactions that significantly alter the risk/return profile of the company's business operations;
- major commercial or financing transactions concluded with some (but not all) of the company's shareholders;
- actions or decisions that directly or indirectly affect an ongoing or anticipated proxy battle or takeover bid;
- transactions requiring court approval (especially plans of arrangement); and
- post-acquisition disputes (such as fights over earn-outs or directorships).

Practical Steps to Prevent an Oppression Claim

1 Anticipate complainants' discontent and give it due consideration.

When a board foresees that a proposed transaction, decision or other action may generate discontent from a potential complainant (such as a major shareholder, an activist shareholder or a bondholder), the board should (i) consider the situation, the interests and the concerns of the potential complainant; (ii) demonstrate appropriate attention to the rights and legitimate expectations of the potential complainant; and (iii) if appropriate, consider possible steps that would address or alleviate these concerns. All of these actions should be clearly documented in the minutes of meetings held by the company's board, as discussed below.

Chapter 4 of our 2020 edition of *Davies Governance Insights* contains a detailed discussion of best practices to employ when dealing with corporate activists.

2 Ensure public disclosure is current and enables flexibility.

Oppression claims against public companies can result from measures taken by the company in response to unexpected situations, such as the appearance of an activist shareholder, a takeover bid or unanticipated financial challenges. Complainants may attempt to establish that the impugned action, decision or transaction was inconsistent with prior public statements made by the company. In that regard, Ontario courts have noted, "the public pronouncements of corporations, particularly those that are publicly traded, become its commitments to shareholders within the range of reasonable expectations that are objectively aroused" (_Rooney v ArcelorMittal_, at para 71, as quoted in _Ford Motor Co of Canada v OMERS_). Consequently, boards should expect that a complainant will closely review all recent public disclosure of a company to identify contradictory statements.

All public disclosure – including annual reports, annual information forms, press releases, investor presentations, answers given at investor meetings, interviews or other interactions with journalists – can inform the reasonable expectations of a corporation's shareholders, bondholders and other potential complainants.

In addition, a company and its board should ensure that its public disclosure and safe harbour language, as well as any descriptions of plans and projections for the future, are current and provide appropriate flexibility to pursue new courses of action or opportunities that may be contemplated.

3 **Prepare and maintain minutes of board meetings in real time.**

Minutes of board and committee meetings (including meetings of any special committee or ad hoc committee) often form part of the evidentiary record in oppression proceedings. The company and the board may seek to rely on the minutes to help establish that their decisions followed a proper process and took into account all matters appropriate for consideration. There should be only one set of approved minutes, which should be maintained by the corporate secretary and kept secure with the company's corporate minute books.

Minutes should be prepared and maintained in real time, particularly in the context of a material transaction or decision. Real-time preparation and maintenance of minutes are not only best practices, but may also be necessary to comply with real-time regulatory reviews by Canadian securities regulators in connection with conflict of interest transactions. In addition, in the case of potentially contentious or contested situations, or where the risk of litigation or regulatory scrutiny is heightened, it may be prudent to seek advice from external legal counsel before preparing or finalizing minutes.

There is no one-size-fits-all rule regarding the appropriate level of detail to include in minutes. The level of detail will depend on, among other factors, the nature of the issues under consideration, their foreseeable contentiousness or scope for scrutiny, the corporation's past practices with respect to minute-taking, the length of the meetings and the number of issues discussed. However, the following practices may be advisable:

Real-time preparation and maintenance of minutes are not only best practices but may also be necessary to comply with real-time regulatory review by Canadian securities regulators in conflict of interest transactions.

- The minutes should accurately reflect the process that the board or committee followed.
- The minutes should cover the topics considered; the scope of discussion, with a fair and accurate summary of the directors' debate; the issues canvassed; any external advice obtained; and the documents and agreements reviewed. They should also disclose any *in camera* sessions.
- Actual or perceived conflicts of interest should generally be declared, recorded and appropriately managed at the outset. Where appropriate, the minutes should record the exclusion of conflicted directors or management from the discussion.
- Minutes should generally list attendees and record the entry or exit of non-directors, such as management, advisers or other parties. Doing so can help establish that the directors devoted sufficient time to considering the relevant issues and did so in the absence of any potentially conflicted parties.
- The minutes should not function as a transcript of the meeting, but rather a clear and concise description of it.

Any material in the minutes that is potentially subject to solicitor-client, litigation, settlement or other form of privilege should generally be clearly and expressly identified. This practice can be of great assistance if it becomes necessary to segregate privileged from non-privileged matters during the litigation process. It can also limit the risk of the company or its counsel inadvertently producing privileged material.

In this regard, it is important to bear in mind that minutes are not necessarily privileged simply because legal counsel is present. While the minutes might record the fact that privileged advice or information was received, it may be prudent in some cases to avoid recording the actual content or outcome of the privileged advice.

4 Manage potential conflicts of interest.

Complainants often allege that the impugned action, decision or transaction was tainted by a conflict of interest (real or imagined) by key decision-makers on the board or management. To pre-empt, manage or defend itself against such allegations, a company and its board can do the following:

- Establish and adhere to policies that are set out in writing, have regard to best corporate practices and are tailored to the company's specific needs. These policies can encompass such matters as the assessment of the independence of directors; board refreshment; and the identification, documentation and disclosure of conflicts by members of the board and management.
- In appropriate circumstances, consider establishing a special committee of the board, made up of independent directors, to review and approve material decisions and actions.
- In appropriate circumstances, authorize and encourage the special committee to obtain legal and financial advice from independent advisers whose compensation structure is not dependent on any particular action or board decision.

Chapter 1 of our 2020 edition of *Davies Governance Insights* contains a detailed discussion of statutory requirements and best practices for special committees.

The term "special committee" may suggest that a real or potential conflict is being addressed. If a temporary committee is created by a board for another purpose (such as more closely supervising a deal negotiation or other project), it may be prudent to use a different term, such as "ad hoc committee" or "strategic review committee" to avoid confusion.

Spotlight: Oppression Versus Other Causes of Action

Oppression claims are similar to, and are often pursued in conjunction with, other causes of action, including the following:

- **Derivative actions.** A derivative action is a claim brought by a shareholder *on behalf of* a corporation, typically against an officer or director for alleged breach of duty to the corporation. Derivative actions can only be commenced with the specific leave (or permission) of a court. When an impugned action, decision or transaction giving rise to an oppression claim has affected all shareholders generally, rather than prejudicing the complainant specifically and uniquely, a court may dismiss the oppression claim on the basis that it properly constitutes a derivative action for which leave was not sought.
- **Securities proceedings.** Securities regulators and stock exchanges have jurisdiction over a range of issues relating to, among other things, the sufficiency and timeliness of public disclosure as well as the fairness of defensive measures against takeover bids. Securities proceedings and oppression remedies can sometimes proceed in parallel and raise overlapping issues.
- **Securities class actions.** Securities legislation in each province creates a statutory cause of action that allows a "representative plaintiff" (putatively acting on behalf of some or all of a company's securityholders) to bring a class proceeding against the reporting issuer, its directors and other parties on the ground that the company's mandatory public disclosure has been false, inadequate or misleading.
- **Civil liability (breach of contract or tort).** When a complainant's "reasonable expectations" are based on a contract or on representations made by the company or individual officer or directors, the complainant may also state claims for breach of contract and/or tort (such as negligent misrepresentation, fraud, conspiracy and intentional interference with economic relations).
- **Plan of arrangement.** When a corporation seeks court approval for a plan of arrangement, a shareholder or creditor whose rights are being "arranged" may challenge the plan on the basis that it is not fair and reasonable.
- **Dissent proceedings.** When a corporation undertakes certain major transactions affecting its capital structure (such as through an amalgamation, plan of arrangement, going-private transaction or squeeze-out transaction), a shareholder can sometimes exercise "dissent rights" and demand that its shares be redeemed for fair value as determined by a court.

5 Ensure compliance with corporate governance guidelines and established practices.

A company's own corporate governance policies, committee mandates and position descriptions can all inform the reasonable expectations of shareholders and other potential complainants. Companies that, for whatever reason, do not comply with their own established policies, or whose policies deviate significantly from recognized best practices, may make themselves more vulnerable to oppression claims if the non-compliance and deviations cannot be adequately explained.

Consequently, a company should ensure that its corporate governance policies have appropriate regard for best practices, tailored to the particular needs and situation of the company. At the same time, however, the company should also develop policies that are sufficiently flexible to provide guidance for both everyday and unusual corporate governance situations, including the efforts of an activist shareholder or other potential complainant.

Should a company find it necessary or appropriate to amend or deviate from its publicly stated or usual governance practices, the reasons for the amendment or deviation – including why the particular amendment or deviation was considered necessary or appropriate – should be carefully documented. In addition, if ever a deviation from a guideline is indicated, the company should carefully consider whether the guideline remains appropriate and, if not, amend it accordingly to better meet actual needs and practices.

6 Manage the flow of information, having regard to mixed messages, privilege and confidentiality.

Written communications (such as emails, texts, instant messages or personal notes), even if confidential, may be required to be produced in litigation. Board members and senior management should operate on the assumption that anything written on paper or electronically, unless clearly subject to privilege, may one day be reviewed by a complainant and/or a judge.

PRIVILEGE

Directors should be aware of three types of privilege in particular: (i) solicitor-client; (ii) litigation; and (iii) settlement.

Solicitor-client privilege applies to confidential communications with an attorney for the purpose of obtaining legal advice. Litigation privilege is broader than solicitor-client privilege and applies to confidential communications, research, analyses and other documents created for the "dominant purpose" of litigation. Settlement privilege applies to confidential communications between opposing parties offering concessions to explore a settlement of existing or threatened litigation.

Simply copying in-house or external counsel on a communication does not necessarily make the communication privileged. Moreover, using in-house or external counsel to relay non-privileged information likely does not cloak such otherwise non-protected information in privilege. To the contrary, the overinclusion of in-house or external counsel in communications unrelated to the provision of legal advice can make matters more difficult if it becomes necessary in the future to divide a potentially massive trove of materials into privileged and non-privileged categories.

Communications or documents can lose their privileged status if they are disclosed, on a non-confidential basis, to third parties within or outside the organization. Moreover, in litigation, a party cannot cherry-pick which privileged communications to disclose to the opposing party. As a result, disclosing some privileged communications may result in loss of the privilege that would otherwise have protected all related communications. Consequently, a public company should take appropriate steps to preserve the confidentiality of all privileged materials. No potentially privileged materials should be disclosed without careful review by counsel to consider all of the potential implications.

The following are some of the steps that public companies can take both to ensure that privilege attaches to a document or communication and to safeguard against that privilege being inadvertently waived:

- Clearly label as "privileged" emails and other communications that are intended to be privileged.
- At the same time, do not indiscriminately label emails and other communications "privileged." Overuse of the privileged label can create risks, including the possibility that documents properly labelled as privileged may not be accepted as such, or that documents needed to establish the company's position cannot be produced without the risk of waiving privilege over other documents.
- Do not distribute privileged materials, either within or outside the organization, more broadly than is reasonably necessary. As a general rule, distribution of privileged materials should be made with legal advice and limited to a small subset of persons who need to participate in the communication.
- Copy legal counsel on the communication of privileged information.
- Adopt and follow best practices with respect to confidential information in general.

CONFIDENTIALITY

The board and management should adopt best practices to protect the confidentiality of the company's documents, data and information. Disclosure of confidential information of any kind – in addition to raising a host of other commercial, regulatory and legal issues – can inspire or catalyze an oppression claim.

The company should have a code of conduct – consistent with best practices as adapted to the particular circumstances of the company – specifying the confidentiality obligations binding on each director, officer and employee. Board members in particular should be aware that all board materials – as well as all discussions and deliberations among board members, both at formal meetings and during informal interactions – are confidential. Minutes and other documents provided to directors should generally be shared only via secured platforms.

Public companies should maintain a system to preserve the integrity of their computer systems from infiltration and attack. In addition, board members (especially independent board members who do not use the company's IT systems) should ensure that their personal computers, hard drives and email systems are secure. Depending on the particular needs of a board's members, the company might consider providing its directors with access to ongoing training in data security.

7 Confirm that insurance provides adequate coverage.

Oppression claims often name both the corporation and the individual directors as defendants. Consequently, a public company should ensure that its liability and/or D&O insurance provides adequate coverage for directors who are named personally in oppression or breach of duty claims. Proper coverage should, among other protections, provide officers and directors with the right to retain separate counsel when separate legal representation is necessary or appropriate.

Our Take: Prevention Is Ideal but Preparation Is Key

Oppression claims against public companies can impose significant costs upon both the company itself and its officers and directors personally. A public company board can help protect itself against an oppression claim by

- being aware of the circumstances that can give rise to oppression claims;
- anticipating possible areas of concern or sensitivity and ensuring that the rights and legitimate expectations of potential complainants are afforded appropriate consideration in decision-making – even if such consideration is not always reciprocated;
- considering and appropriately managing conflicts;
- being mindful of and considering its prior public disclosure and established policies before making significant decisions or concluding important transactions;
- carefully managing the flow of confidential and privileged information and documents;
- maintaining adequate liability and D&O insurance; and
- preparing and maintaining fair and accurate minutes of meetings.

CHAPTER 03

CEO Succession Trends and Best Practices

Succession planning for and oversight of the chief executive officer (CEO) is often addressed only once a year during the board's annual strategy session, despite being a particularly important board function. Recent data suggest that CEO tenure is declining and CEO turnover is increasing. Whether this trend is attributable to normal refreshment, evolving strategies in response to COVID-19, and/or increased instances of mismanagement or misconduct, CEO succession is an important factor that must be considered by a board when planning for the company's future. In this chapter, we review recent trends in CEO departures, offer practical guidance on succession planning best practices and considerations, and discuss some core disclosure issues that boards should factor into their overall succession planning strategy.

Recent Trends in CEO Departures

In July 2021, The Conference Board released *CEO Succession Practices in the Russell 3000 and S&P 500: 2021 Edition*, its annual benchmarking study that documents and analyzes succession events of CEOs of major publicly traded companies in the United States over the previous year (Conference Board Report). The following are our analyses of some of the key themes identified in the Conference Board Report.

- **CEO turnover lagged in Q2 2020 before returning to normal levels by the end of 2020 and early 2021.** As companies attempted to navigate the tumult caused by the pandemic, boards seemed to prioritize continuity of CEOs. In fact, several CEO departures announced in late 2020 and early 2021 were originally planned for early 2020, but postponed. This was also true for some Canadian companies. Calin Rovinescu, CEO of Air Canada (listed on the Toronto Stock Exchange (TSX)), cited the pandemic as the reason for delaying his original retirement plans until February 2021. However, succession announcements picked up significantly in the second half of 2020, suggesting that boards felt more comfortable pursuing succession plans once they better understood the impact of COVID-19. The December 2021 *CEO Turnover Report* published by Challenger, Gray & Christmas, Inc. recorded 1,337 CEO resignations in 2021, a 1.8% increase over the 1,314 CEOs who left their posts in 2020. Now that we have passed the two-year mark of the pandemic, we expect CEO departure rates will continue to rise.

- **CEO tenure is declining.** The average tenure among S&P 500 CEOs in 2020 was 6.1 years, representing a significant decrease from the 10.8-year average tenure among S&P 500 companies a mere five years ago. Tenure levels are expected to continue to decline in the coming years as CEO turnover rates continue to increase.

- **CEO performance metrics are expanding to include non-financial criteria.** Historically, companies that performed better from the perspective of shareholder return tended to experience significantly lower succession rates than those that performed poorly. According to the Conference Board Report, in 2020 the gap was the narrowest it has been since 2014 and was four times smaller than the gap in 2019 – the worse-performing companies on the S&P 500 had a succession rate of 12.7%, whereas better-performing companies had a succession rate of 10.5%. Although total shareholder return and financial performance are and always will be important factors, the data indicate that CEO performance metrics are expanding to include non-financial criteria with an emphasis on environmental, social and governance (ESG) issues, such as diversity and inclusion and climate change. For example, increased pressure from activists and investors led six of Canada's largest banks to tie CEO performance and pay to ESG metrics as an indication of the banks' commitment to these critical issues.

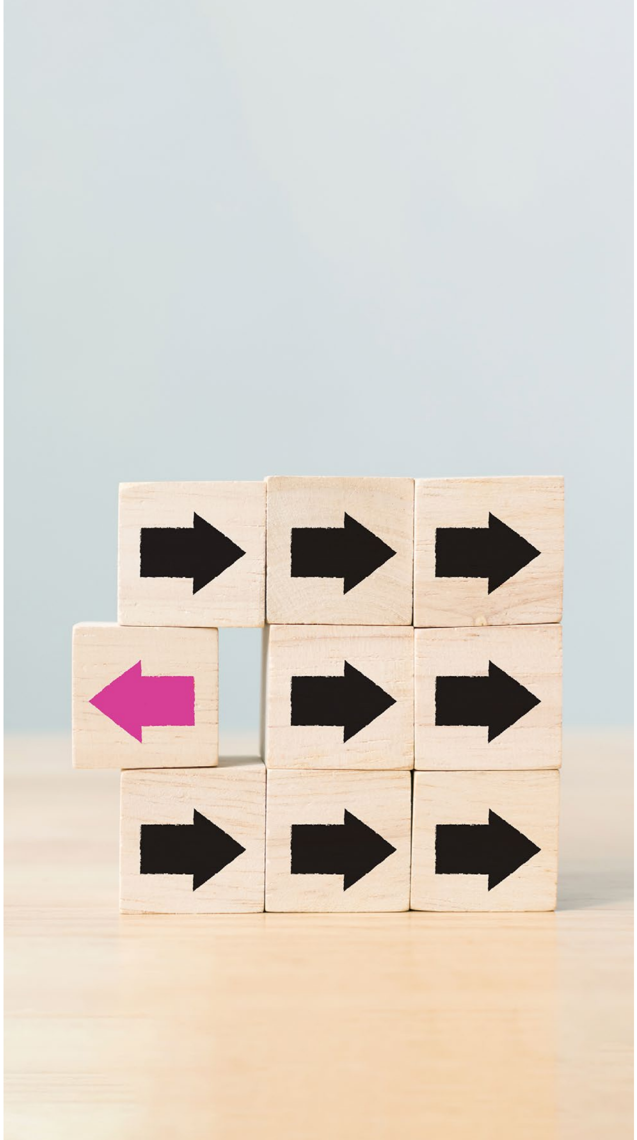
- **Fewer interim CEOs are being appointed.** Interim CEO appointments reached a four-year low in 2020. This was mostly attributed to the need to eliminate uncertainty during the turbulent times caused by the pandemic and to present a more robust and well-considered succession plan to stakeholders. Among select CEO departures, interim successors were appointed only when an unexpected or sudden departure occurred and the board appeared to struggle to find a viable candidate to appoint as a permanent successor. In this situation, data reveal that a board member, often the board chair, steps into the interim CEO role. This was the case in the high-profile CEO departure of Terry Booth from TSX-listed Aurora Cannabis Inc. on February 6, 2020.

– **More non-executive directors are being appointed as successor CEOs.** In 2020, approximately 23% of CEOs appointed to Russell 3000 companies were non-executive directors compared with just 16.4% in 2017. In 2020, companies in the healthcare, utilities and information technology sectors ranked among the highest percentage with non-executive directors appointed as CEOs, at 44%, 36% and 24%, respectively. This is in stark contrast to 2017, in which these percentages were 27%, 17% and 18%, respectively. Business outlook, specialized industry knowledge and talent availability could explain why more non-executive directors are transitioning into CEO roles in these sectors.

Reasons for CEO Turnover: Davies Study

Each year, companies provide various reasons for CEO departures, ranging from voluntary retirement to termination for mismanagement. Those reasons can have implications for the company in both the short and the long terms. According to our study of selected data regarding high-profile CEO departures since 2020, the primary reasons for CEO departures were as follows:

– **Retirement policy or regular succession planning.** Several companies have policies that contemplate a mandatory retirement age for CEOs and/or require that they resign after a specified number of years. Some market participants view mandatory retirement age policies and term limits as useful tools that provide predictability and enable other qualified individuals to transition into the CEO role. Others argue that these policies can force high-performing leaders to retire at an arbitrary age and are no longer necessary in an era in which boards are much more engaged in CEO oversight.



Although total shareholder return and financial performance are and always will be important factors, the data indicate that CEO performance metrics are expanding to include non-financial criteria such as diversity and inclusion and climate change, with an emphasis on environmental, social and governance (ESG) issues.

- **Underperformance.** A board may feel compelled to terminate a CEO in the face of consistently poor financial results or because of actual or perceived flaws in the company's business or strategy. As one might expect, this is particularly likely to occur when vocal shareholders begin demanding change, whether privately or publicly, underscoring the need for boards to engage with stakeholders and be responsive to their concerns. A recent high-profile example is John Foley's departure as CEO of Peloton Interactive, Inc. in February 2022, following activist investor Blackwells Capital, LLC's campaign after post-pandemic sales dwindled considerably. Blackwells cited failed forecasting, inconsistent strategy and governance problems among its reasons for demanding Foley's resignation. In July 2022, Mark Little abruptly resigned as CEO of Suncor Energy Inc. following the latest of a series of fatalities at Suncor's sites that highlighted the company's poor safety record and failure to fix operational concerns with its business.

- **CEO misconduct.** One of the most common reasons for forced CEO departures is personal misconduct. This is characterized by the CEO's improper or generally objectionable behaviour, such as abuse of power. In June 2020, U.S. brand CrossFit, LLC's CEO resigned following a public outcry over distasteful and offensive tweets pertaining to the murder of George Floyd and the COVID-19 pandemic. As companies are increasingly expected to be model corporate citizens, so too are their leaders. This has resulted, and will continue to result, in boards and stakeholders having little tolerance for CEO behaviour that jeopardizes a company's reputation.

- **Personal reasons.** CEOs occasionally and unexpectedly resign for personal reasons, which may include health concerns or family matters. Personal reasons were cited in the departure of the CEOs of both New York Stock Exchange (NYSE)-listed Tyson Foods Inc. and TSX- and NYSE-listed Nutrien Ltd. When personal reasons are cited, there is often some share price decline and increased trading volume, as these departures are rarely accompanied by much notice to the market. Some may also view a departure for personal reasons as a subterfuge concealing a more troubling "real" reason for the CEO's departure, which in turn could cause investors to lose confidence in the company.

- **Legal non-compliance.** More rarely, a CEO may be forced to resign because of a breach of law, pending litigation or investigations, or criminal activity. In June 2021, NYSE-listed Lordstown Motors Corporation's CEO resigned after a special committee of the board investigated inquiries made by the SEC and discovered that some of the company's statements regarding vehicle pre-orders were inaccurate and misleading. Legal non-compliance, or even allegations of legal non-compliance, calls into question not only the CEO's ability to continue to serve the company, but also the board's effectiveness in overseeing management and the company's affairs.

A board may feel compelled to terminate a CEO in the face of consistently poor financial results or because of actual or perceived flaws in the company's business or strategy.

Spotlight: McDonald's CEO's Termination Owing to Consensual Relationship

On November 3, 2019, NYSE-listed McDonald's Corporation announced that then-CEO Steve Easterbrook had left the company. The McDonald's board of directors stated that he "violated company policy and demonstrated poor judgment involving a recent consensual relationship with an employee." After months of investigation stemming from an internally filed complaint, McDonald's terminated Easterbrook without cause and awarded him a severance package valued at about US$100 million. The board quickly appointed Chris Kempczinski, then-president of McDonald's USA, to take the reins. McDonald's share price dropped 5% by the end of the day and 3% one week after the announcement. The saga continued in August 2020 when McDonald's sued its ex-CEO seeking to claw back the compensation, alleging that he destroyed evidence and lied to investigators about multiple affairs with employees.

Both the initial severance package and the subsequent lawsuit raised questions about the board's initial investigation, including why the investigation ended so quickly and why the additional evidence had not been discovered at the time. Investment firms, including SOC Investment Group (formerly CtW Investment Group) and the California Public Employees' Retirement System, led a campaign urging shareholders to vote against the election of board chair Enrique Hernandez, Jr. and compensation committee chair Richard Lenny over their "flawed and mismanaged investigation into former CEO Steve Easterbrook's misconduct that led to the Board's ill-fated decision to terminate him 'without cause...'"

The board's management of the Easterbrook situation divided shareholders, including proxy advisory firms. Glass Lewis & Co. recommended that shareholders vote against Hernandez and Lenny. However, Institutional Shareholder Services Inc. (ISS) recommended that shareholders vote in favour of re-electing Hernandez and Lenny, citing the quick and smooth transition the board ushered in by appointing Kempczinski to lead the company. While acknowledging the initial investigation was flawed, ISS commended Hernandez and the board for keeping executives accountable for misconduct and for pursuing legal action to claw back Easterbrook's severance package upon learning more details.

Fortunately for McDonald's and its board, Kempczinski quickly proved himself a more than adequate successor, and McDonald's share price rebounded within 35 days. In December 2021, McDonald's was able to claw back an estimated US$105 million paid to Easterbrook in severance for his termination in 2019. The settlement allowed the company to avoid protracted litigation and move forward.

Still, the McDonald's tale highlights the importance of boards keeping executives accountable, determining appropriate severance packages in light of the circumstances, planning effectively and proactively for unexpected CEO departures and selecting successor CEOs like Kempczinski who will maintain a successful corporate strategy.

Impact of Unexpected CEO Departure Without a Succession Plan

CEO departures can have severe consequences for a company, depending on whether the departure was planned and how clearly the company communicated the transition.

- **Reputational damage.** After an unexpected CEO departure due to mismanagement or misconduct, the company will invariably suffer reputational damage. However, reputational damage can occur even in the absence of such events when an unexpected departure occurs without an obvious succession plan in place because it highlights the board's lack of appropriate oversight and preparedness. It also signals to the broader market and competitors that the company is going through a challenging transition as it scrambles to find a new leader.

- **Stock price volatility.** Increased stock price volatility and declining stock prices, sometimes for prolonged periods of time, are often by-products of unexpected CEO departures. Trading volumes spike as shareholders re-evaluate whether they still have confidence in the company and whether they agree with the board's choice of successor (if one has been named). In 2021, on the day Nutrien announced that its CEO was stepping down immediately, trading volume spiked 93% from the prior trading day, and the share price dropped 3% by the end of the day and remained at that level for more than two weeks before recovering. In early 2022, Nutrien once again announced an unexpected change of CEO following which its share price dropped 4%.

- **Internal issues.** CEO departures, especially unexpected ones, can also have negative implications for the company's other senior officers. They may struggle to align themselves with a new CEO or disagree with the board's handling of the previous CEO's exit. An incoming CEO may also shuffle the management team at the start of their tenure, resulting in other members of management pre-emptively departing to seek out more secure positions elsewhere. Accordingly, the external and internal communications about a CEO's departure are particularly important in preventing the unintended loss of other valuable members of the leadership team.

- **Shareholder activism.** Shareholders are attuned to the actions of a board and may demand change when they have concerns regarding the process by which a CEO is replaced or have questions about the board's approach to succession planning generally. As noted in the previous Spotlight, certain McDonald's shareholders led a campaign to oust the board chair for his mishandling of the CEO's resignation.

- **Business continuity.** Lastly, a change in CEO will have implications for the company's future, whether or not the succession was planned. The new CEO may have a different vision for the company that results in a strategic pivot, or unique aspects of the company may make the transition particularly challenging. There can also be a loss of institutional knowledge and core relationships with key suppliers, customers, regulators and other stakeholders.

Reputational damage can occur even in the absence of such events when an unexpected departure occurs without an obvious succession plan in place because it highlights the board's lack of appropriate oversight and preparedness.

Disclosure Trends with CEO Departures

Companies' legal disclosure obligations in the context of a CEO departure, whether planned or unexpected, can be complex. Our data reveal some interesting trends with respect to the governance practices of U.S. and Canadian public companies and the impact that notice of CEO departures can have on a company's share price:

- **Press release/material change report.** All U.S. and Canadian issuers that we reviewed issued press releases announcing their CEOs' departures. However, practice diverged when it came to filing a material change report (for Canadian issuers) and a Form 8-K (for U.S. issuers). In Canada, a material change report is required whenever a change in the business, operations or capital of an issuer occurs that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the issuer. National Policy 51-201 – *Disclosure Standards* specifically references "the departure of the company's CEO" as possible material information. In the United States, a Form 8-K is required in a variety of specified circumstances, including the resignation or termination of senior executive officers. Although 100% of issuers filed a Form 8-K announcing a change in CEO, only 50% of Canadian reporting issuers in our study filed a material change report. Of the TSX -listed issuers reviewed, most that filed a material change report did so in connection with a sudden or unexpected CEO departure.
- **Transition period.** In situations in which the succession appeared to be a planned process, the average notice the issuer gave to the market was 108 days. However, there were still circumstances in which planned successions were announced with little or no notice. For example, TSX-listed Transat A.T. Inc. announced its CEO's retirement on May 26, 2021, with his successor taking over the role the following day. In January 2022, Montréal-based Fiera Capital Corp. announced the appointment of a new CEO a full year before the company had initially planned in its three-year succession plan. The appointment took effect retroactively on January 1, 2022.
- **Impact on share price.** Our data show some correlation between the amount of notice provided to the market of a CEO's departure and the company's share price. As illustrated by Figure 3-1, companies that provided more notice experienced less volatility and no significant change in their one-day share price, whereas those that provided little to no notice saw their share price decline by an average of 2%. Generally, share prices improved within one week or one month following the announcement, as seen in Figure 3-2.
- **Severance.** The press releases announcing CEOs' departures did not all disclose severance details. In cases in which the departure was forced and the market reaction negative, severance details were typically outlined in the corresponding material change report or Form 8-K. Although disclosure is required in the company's annual management information circular, disclosing the terms or key components of the severance package contemporaneously with disclosure of the change is encouraged in order to maximize transparency.

FIGURE 3-1: **Change in Share Price vis-à-vis Length of Notice of CEO Departure**

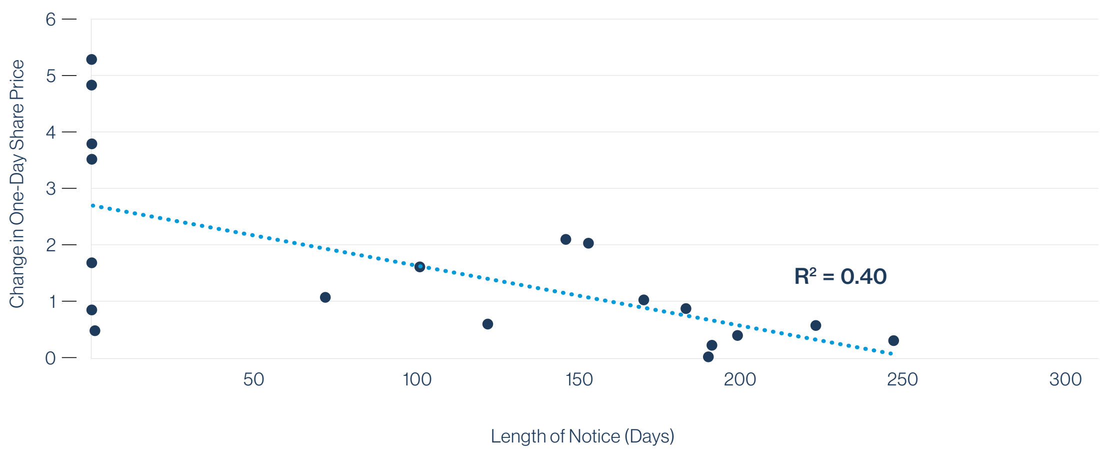
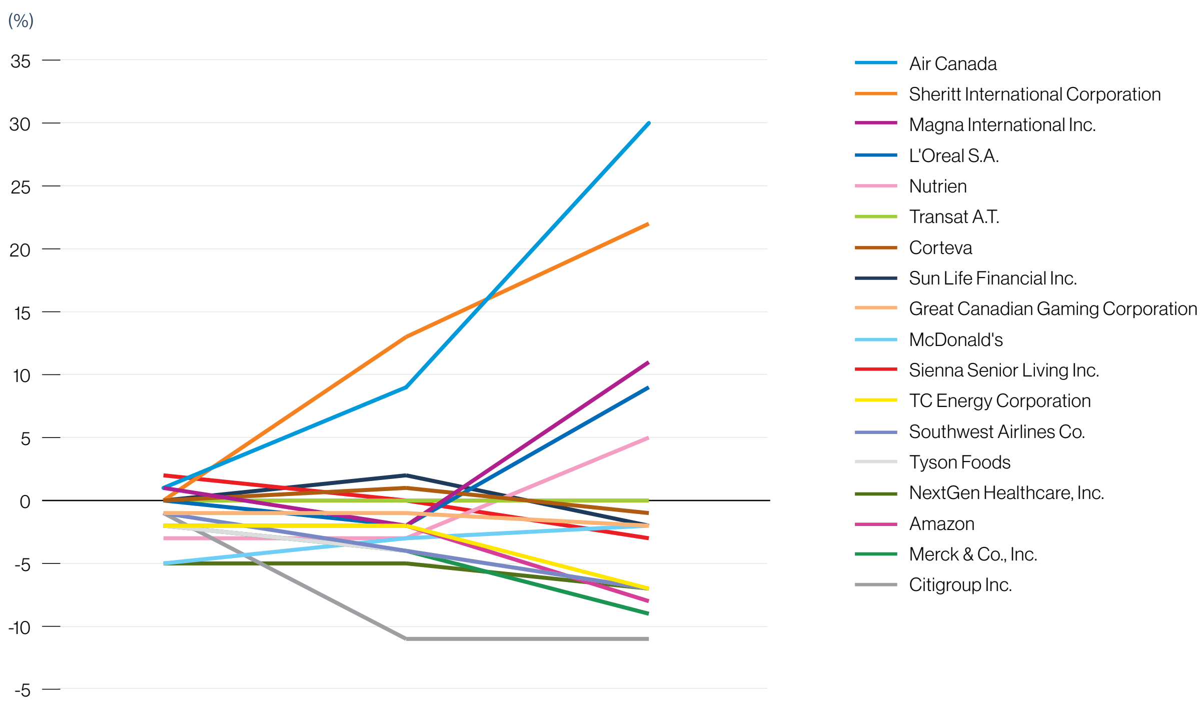


FIGURE 3-2: **Share Price Recovery Post-Announcement**



Spotlight: Second Nutrien CEO Resigns in Less Than a Year

On January 4, 2022, Nutrien announced that its recently appointed president and CEO, Mayo Schmidt, had resigned his position and was stepping down from the company's board of directors effective immediately. Schmidt was appointed to succeed Nutrien's outgoing CEO, Chuck Magro, in April 2021 and held the position for only eight months before his unexpected resignation. He was replaced as CEO on an interim basis by Ken Seitz while the company commenced a global search for its next CEO.

Nutrien gave no reasons for Schmidt's abrupt departure, citing legal constraints on what the company could disclose. This was notably also the case with the resignation of Magro in 2021. The short transition period and vacuum of information left room for speculation of dysfunction within Nutrien's senior management. Within 24 hours of the announcement, the price of Nutrien shares fell by 4% on the TSX, a more significant decline than the previous 3% fall in the share price when the company changed CEOs in 2021.

The rapid CEO successions also came at a major price to the company in the form of severance payments. According to Nutrien's most recent management information circular, the company paid Magro US$18.48 million in 2021, including a US$7.98 million severance payment, while Schmidt collected US$14.22 million, including US$4.83 million in severance, for his eight-month tenure. In addition to falling share prices and severance payments, Nutrien's declared "global search" for a new CEO is sure to cost the company in terms of management and board distraction as well as financially. The company clarified that it will be considering both internal and external candidates in the hope of finding a permanent successor.

The Nutrien case highlights the importance of carefully considering messaging regarding succession plans both before and after a CEO departure. Rapid and unexpected changes marked by board resignations, unclear succession plans and reasons that insinuate discord erode investor confidence. Characterization of a CEO departure calls for a delicate balancing act between respecting the outgoing CEO's privacy and accurate disclosure that pre-empts speculation of a scandal. Additionally, public disclosure should be accompanied by consistent but more "user-friendly" internal messaging to employees and core stakeholders to retain their confidence that the company and its board have matters under control.

Spotlight: MasterCard: A CEO Succession Plan a Decade in the Making

On February 25, 2020, NYSE-listed MasterCard announced that its CEO, Ajay Banga, would be stepping down and that Michael Miebach would be appointed to lead the company. In a subsequent interview, Banga and then-board chair Richard Haythornthwaite revealed that an extensive CEO succession planning process had been in place at MasterCard for the previous 10 years – essentially from the moment that Banga had been appointed.
The MasterCard approach highlights many key features of a successful succession planning process.

- **Start early.** Planning for the next MasterCard CEO began almost contemporaneously with Banga's appointment. For the next 10 years, Banga and Haythornthwaite committed to identifying talent early on with an open mind, allowing them to take their time pinpointing the best person to fill Banga's shoes.

- **Cast a wide internal net.** At the outset, Banga and Haythornthwaite identified 42 potential internal candidates. They then spent years monitoring and evaluating each person in order to narrow down their list. Starting with such a large talent pool list minimized the risk of overlooking qualified individuals and enabled board members to build relationships and critically evaluate candidates over a long period of time.

- **Give candidates opportunities to grow.** Banga ensured that candidates were shuffled to different departments and roles every few years to allow them to gain broad exposure to the entire company and build expertise in multiple areas. Banga moved Miebach out of his role as head of Asia to chief product officer, helping him gain competencies in areas that his previous role could not offer.

- **Involve the entire board of directors.** Banga and Haythornthwaite believed that the entire board should participate in the succession planning process rather than just the nominating and corporate governance committees or a special committee comprising select members of the board. This afforded each director the opportunity to provide their own unique perspective regarding the skills and qualities that MasterCard's next CEO should possess.

- **Seek advice from external advisers.** MasterCard hired an external leadership advisory firm that conducted impartial analyses of potential candidates. The adviser held personalized coaching sessions and development training for each candidate and provided an unbiased opinion regarding who it believed would be the best fit for the company.

- **Transition CEO to board chair.** When Banga's departure was announced, MasterCard also announced that he would become board chair and would work closely with Miebach in supervising the management and affairs of the company. MasterCard correctly anticipated that Banga's ongoing involvement would provide the company with a measure of continuity in the face of significant change and thereby keep investor confidence high. Banga stepped down as chair of the board in December 2021, thereby successfully completing a thoughtful and intentional planned executive transition.

Several other major companies have adopted similar methodical approaches to succession planning that are worthy of emulation. Indra Nooyi left NYSE-listed PepsiCo, Inc. as CEO in 2018 after leading the company for 12 years. Upon her departure, the board revealed that it had followed a rigorous succession planning process. Nooyi had, among other things, worked closely with the board to maintain a list of internal and external candidates, developed criteria for qualities that her successor should possess and provided short-listed candidates with opportunities to lead and learn.

Succession Planning as an Ongoing Process: Governance Best Practices in CEO Succession Planning

The key to an effective CEO succession plan is ensuring that it remains an ongoing process. Given the significant consequences that can accompany a leadership change, the best succession plans include both a long-term plan and an emergency plan to manage the risks and legal obligations associated with a sudden and unexpected departure. Here are some tips to keep top of mind:

- **Set up a committee.** Establish a board committee charged with oversight of CEO and C-suite succession planning, and ensure the board's mandate and the committee's charter accurately reflect their respective responsibilities. This will help to ensure that the issue receives the requisite attention and does not fall through the cracks.
- **Create a working plan.** Determine what the succession planning process will look like in both the short and long terms, including the search process that will be implemented (i.e., whether internal or external), the competencies required of a successor CEO, whether external advisers will be retained to provide an unbiased review of potential successors, and other procedures and milestones. Regularly review and update the plan in the context of the company's evolving strategy and goals.
- **Listen to stakeholders and consider leaders' perspectives.** Discuss CEO succession plans, changes and developments on a regular basis both with board members and with the current CEO. Address the issue at quarterly board meetings rather than merely at an annual strategy session. Regularly solicit feedback from a variety of stakeholders, many of whom likely have their own expectations for the company and its leadership.
- **Maintain and update evergreen lists of internal and external candidates in real time.** Whether the company plans to groom internal candidates or search externally, it is necessary to ensure there are people responsible for tracking candidates' performance and progress and for monitoring market events that may influence these candidates' willingness or availability to be considered in the future. Have contingency plans if the most logical successors are uninterested or become unavailable.

Given the significant consequences that can accompany a leadership change, the best succession plans include both a long-term plan and an emergency plan to manage the risks and legal obligations associated with a sudden and unexpected departure.

- **Groom internal candidates.** If the company intends to groom its next successor internally, it is necessary to invest in training and ensure potential internal successors are given real-world opportunities to showcase that they have what it takes to lead the company. They should also interact regularly with directors in order to cultivate a rapport that will assist the board in making an informed decision about their viability.

- **Plan for events that may affect succession.** Consider conducting annual scenario analyses at either the board or standing committee level, to simulate possible unexpected developments that may affect CEO succession (e.g., misconduct, financial performance or activism). Remember that companies that underperform are more likely to see higher CEO turnover. Consider whether the potential successors are the right people to lead the company today and into the future, and update the criteria to respond to shifts in the corporate environment (e.g., COVID-19, changes in strategy and/or rising prominence of ESG-related issues).

- **Develop and refresh internal and external communications strategies for CEO succession planning.** Providing clarity and transparency to the market, employees, regulators, customers and suppliers is critical. The goal should always be to inspire confidence in the company's management over time, despite significant changes in leadership.

- **Ease the transition process.** Consider creating a role in the management committee (e.g., president or deputy CEO) to simplify and facilitate the successor's eventual appointment. Retaining the current CEO as a strategic adviser or as a member of the board can also help smooth the transition.

Spotlight: Air Canada and Amazon: Orderly Succession Planning and Communication Pay Dividends

Among the most notable and high-profile CEO exits in recent times, Calin Rovinescu's departure from TSX-listed Air Canada and Jeff Bezos' departure from NYSE-listed Amazon.com, Inc., both in 2021, rank at the top of the list and exemplify several best practices regarding succession planning:

- **Ample notice.** Both Air Canada and Amazon provided considerable advance notice of their planned CEO successions. Air Canada gave the market 122 days to digest the news of Rovinescu's retirement, and Amazon provided a lengthy 153-day notice period of Bezos' resignation. These extensive runways not only facilitated a smooth transition but also represented clear signals to shareholders and other stakeholders that they could have confidence the companies were organized and well-prepared for a leadership change.

- **Internal hires with consistent visions.** Air Canada and Amazon both appointed successors from within their respective internal ranks. Air Canada tapped Michael Rousseau, then-CFO and deputy CEO, and Amazon promoted Andy Jassy, then-CEO of Amazon Web Services. Both brought significant experience to the table through either a former crucial C-suite role or after leading one of the company's major business segments. Both incoming CEOs were lauded for having a vision and an outlook for the future of their respective companies that were consistent with those of their predecessors. This alignment helped alleviate any potential concerns that the companies were on the verge of major (and potentially highly disruptive) strategic shifts.

- **CEO to board chair.** An important element in Amazon's succession process was Bezos' continued role as board chair following his departure, which is consistent with other recent successful transitions such as MasterCard Inc. and Merck & Co., Inc. This likely helped bolster shareholders' confidence that Bezos would retain significant influence in shaping the company's future, which is particularly important for companies like Amazon with a founder-CEO.

The approach of Air Canada and Amazon highlights the benefits of following a thoughtfully planned and well-communicated succession process. Notably, both companies experienced only slight changes in their respective share prices upon announcing the planned transition. Amazon's share price dropped just 2% on the date of the announcement, and Air Canada's share price increased by 1%. In contrast, the announcement of the departure of TSX-listed Lightspeed Commerce Inc.'s CEO, Dax Dasilva, in February 2022, led to a drop in share price of over 16%. Investors reacted negatively to Lightspeed's failure to telegraph that a management change was in the works. In addition, the timing of the change occurred during turbulent events for the company because it was in the midst of integrating acquisitions and was under a short-seller attack.

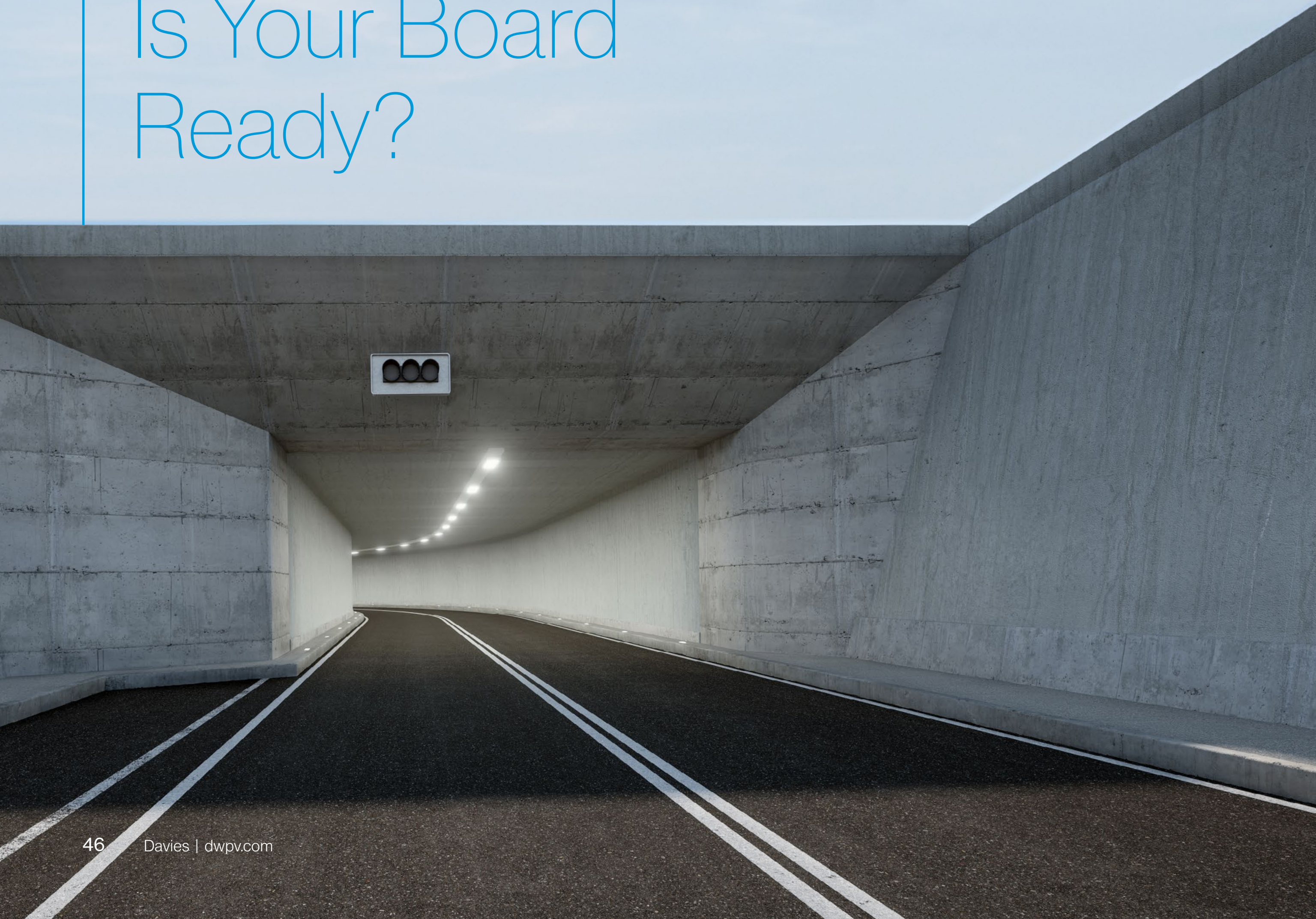
These case studies demonstrate just how far clarity and consistency can go in fostering shareholder confidence and allaying fears that frequently arise in the context of CEO successions.

Our Take: Planning for Success

The CEO succession planning landscape is likely to change significantly in the post-COVID-19 era. First, we may see a more competitive market for senior talent as several CEOs permanently exit the labour force following the trials and tribulations of navigating their companies through the pandemic. Second, we can expect an increased focus on ESG-related metrics in CEO evaluations. As the data shows, the succession rates between better-performing and worse-performing companies have narrowed, suggesting that factors other than financial performance, stakeholder engagement, and diversity and inclusion are becoming increasingly important to boards and stakeholders. Finally, boards must continue to be vigilant in investigating whistleblower complaints and swiftly dealing with CEO misconduct, given the disastrous consequences that failing to do so can have on investor confidence. As the demands on senior management now extend beyond the focus on quarterly earnings, boards must take the time to reassess their current strategies and better position themselves for the fast-changing future. It is essential to have a transition planning process that is not only robust enough to weather the volatile environment, but also clearly communicated to maintain investor confidence.

CHAPTER 04

True Majority Voting for CBCA Public Companies: Is Your Board Ready?



Owing to federal legislative changes which came into force on August 31, 2022, public companies governed by the *Canada Business Corporations Act* (CBCA) are now subject to true majority voting for uncontested director elections. Under the new true majority voting regime, a director will be elected to the board in an uncontested meeting only if the director receives a majority of the votes cast by shareholders. For an overview of this recent statutory change, along with other updates to the CBCA, refer to Development #3 of Chapter 1. In this chapter, we discuss what federal public corporations can do to prepare for true majority voting in advance of their next director election.

Must a CBCA Public Company Amend Its Bylaws to Reflect the Change to True Majority Voting?

The new CBCA majority voting regime operates automatically by statute. Accordingly, an issuer does not need to amend its current bylaws to account for the change, unless (i) the issuer's current bylaws conflict with the new process (for example, the bylaws may specify voting mechanics that are out of step with the new rules), or (ii) the issuer wishes to formalize the uninterrupted continuation in office of unelected incumbents as "holdover" directors (discussed below). In the first scenario, the terms of the statute should prevail in the event of a conflict with an issuer's bylaws. However, an issuer that desires clarity, particularly in the event of contentious circumstances, may nonetheless prefer to make the amendment. Issuers that do not need to amend their bylaws for the aforementioned reasons may of course still replicate the regime in their bylaws simply as a matter of clarity or preferred practice.

The new CBCA voting rules permit an unelected incumbent director to remain in office as a holdover director for up to 90 days or the date on which a successor is appointed, whichever is earlier.

What Can an Issuer Do to Avoid the Disruption of a "Sudden Death" Election?

The new CBCA voting rules permit an unelected incumbent director to remain in office as a holdover director for up to 90 days or the date on which a successor is appointed, whichever is earlier. This grace period was added to the legislation following criticism of the "sudden death" nature of the original draft, which would have terminated such director's term in office immediately after the meeting. Critics pointed out that a director's immediate termination would not only be disruptive to boards but would also place corporations at risk of suddenly falling offside regulatory requirements for director independence (such as the requirement for a Canadian issuer to have an audit committee composed of at least three independent and financially literate directors) or material agreements containing change of control or similar clauses that are triggered by changes in board membership.

The statutory grace period was added to be just that: an additional period of time in which a board can order its house, transition the work of an unelected incumbent director and avert the issuer suddenly falling offside regulatory or contractual requirements at the close of a meeting. As drafted, however, the CBCA is unclear as to how an issuer may avail itself of the grace period. Certainly, the statute grants discretion to permit (or otherwise empowers permitting) an unelected director to continue in office as a holdover: "[the unelected incumbent] director *may* continue in office until the earlier of (a) the 90th day after the day of the election and (b) the day on which their successor is appointed or elected" (emphasis added). What the rule does not do, however, is make clear to whom such power or discretion has been granted – is it to the unelected director or is it to the board or the corporation? Moreover, if discretion must be exercised (whether by the corporation or otherwise), then the director's uninterrupted continuation in office may in fact be disrupted by the period created between the close of the meeting and the decision for the holdover director to continue.

It remains to be seen how issuers and their counsel will address this seemingly unintended legislative ambiguity. One solution may be for issuers to amend their bylaws to prospectively provide that any unelected incumbent director "shall" continue in office until the earlier of the expiry of the grace period permitted by the CBCA and the director's resignation. However, if issuers automate the process for holdover directors in such a fashion, they will also need to preserve flexibility to remove holdover directors prior to the expiry of the grace period. For that reason, we may see issuers establishing appropriate resignation arrangements with their directors.

A potential example of such an arrangement may be found in the issuer-adopted majority voting policies currently mandated by the Toronto Stock Exchange (TSX) (discussed below), which require an unelected incumbent director to tender their resignation to the

board immediately after the meeting and which the board may accept at any time within the following 90 days. Also illustrative may be the established practice of directors undertaking to stock exchanges that they will resign on the happening of certain events (typically, failing to receive stock exchange clearance of a personal information form). Practices developed in other corporate jurisdictions with true majority voting, such as Delaware, may also be a useful reference point. These considerations remain to be digested and settled by market participants.

Any amendments to bylaws will require shareholder approval, which may occasion proxy advisory firms such as Institutional Shareholder Services Inc. (ISS) and Glass Lewis & Co. to provide further guidance on their expectations regarding the way CBCA issuers may formalize holdover director continuance and resignation arrangements. Of course, any proposed changes to an issuer's constating documents should be made with reference to the then-current guidelines of proxy advisory firms. With any luck, we will receive further guidance from proxy advisory firms in advance of the next proxy season.

Does a TSX-Listed CBCA Public Company Need to Adopt (or Continue) a TSX Majority Voting Policy?

Under the current TSX rules, all listed issuers other than majority-controlled corporations must comply with the TSX's requirement that each director "must be elected by a majority (50% + 1 vote) of the votes cast" in a non-contested meeting (Majority Voting Requirement). Listed issuers must adopt a majority voting policy to implement the Majority Voting Requirement. The policy must provide that a director who does not receive the required majority of votes must tender their resignation to the board, even where that director is legally elected to the board under the issuer's corporate statute. The TSX rules go on to provide, however, that a listed issuer is exempt from the requirement to adopt a policy to implement the TSX's Majority Voting Requirement if the issuer satisfies the requirement "in a manner acceptable to TSX, for example, by applicable statutes, articles, bylaws or similar instruments."

The TSX has stated that, once in effect, the majority voting rules of the CBCA "will likely satisfy" the TSX's Majority Voting Requirement, and the TSX "will likely not require" issuers incorporated under the CBCA to have a majority voting policy in place. The CBCA majority voting regime and the requirements imposed by an issuer's TSX majority voting policy may not easily operate side by side if the terms included in the policy conflict with the statutory regime (for example, some policies refer to "for" and "withhold" votes, but proxy cards in the new regime require that votes be "for" or "against"). There may be reason to continue or adopt certain features of the current era of TSX majority voting policies, like the requirement that, following a meeting, unelected incumbents must tender their resignation subject to acceptance of the board (discussed above). As the next proxy season approaches, and perhaps with further guidance from the TSX in hand, TSX-listed CBCA issuers may need to engage in a formal exercise of terminating or amending their TSX-based majority voting policies to conform to the new statutory regime (with accompanying disclosure made in their management information circulars).

How Can an Issuer Reduce the Risk of a Failed Election Under the New Majority Voting Regime?

With true majority voting, at each uncontested meeting an incumbent board will be subject to the risk that a quorum of directors or the number of directors required by the statute or its constating documents will not be elected – an outcome referred to as a "failed election." What is more, the new regime could also inject new potency into public withhold campaigns (presumably to be restyled as "against campaigns") that can now set out to block the election of management nominees as a matter of corporate law. When a failed election occurs, the incumbent directors must promptly call a special meeting of shareholders to fill the vacancy. While the risk of a failed election should prove more theoretical than actual for most issuers at most meetings, the CBCA's elections saving clause was amended on August 31, 2022 to provide that if shareholders fail to elect the number or minimum number of directors required by the corporation's articles because director nominees did not receive the required majority vote, the directors elected may nonetheless exercise all the powers of the board provided that such elected directors constitute at least a quorum. For a board to avail itself of this saving provision, then, at least the required number of directors to establish a quorum must be elected.

The CBCA permits corporations to set the director quorum level in their constating documents, failing which the threshold for quorum will default under the statute to a majority of the number of directors or minimum number of directors required by the issuer's articles. In light of the new risk of a failed election, CBCA issuers should be mindful to review their board quorum and required director levels to determine if any thresholds are unnecessarily high. Issuers that are contemplating any changes to such thresholds should consider the policy guidelines of proxy advisory firms, together with appropriate governance practices. For example, ISS' current guidelines for TSX-listed companies provide that ISS may recommend voting against proposals to amend bylaws that provide for a quorum of directors that is less than 50% of the number of the directors.

In light of the new risk of a failed election, CBCA issuers should be mindful to review their board quorum and required director levels to determine if any thresholds are unnecessarily high.

Will Other Jurisdictions Adopt Majority Voting?

Although the CBCA is currently a Canadian standout in mandating majority voting, it is not unforeseeable that at least some of the provincial and territorial corporate statutes would follow the federal regime's majority voting standard (indeed, a private member's bill to introduce true majority voting to the Ontario *Business Corporations Act* emerged in 2017 but died on the order paper). Companies going public, in particular on exchanges that do not require majority voting, should take into account the election governance responsibilities imposed by the CBCA when considering the appropriate corporate regime for their business.

Our Take: Five Steps to Ensure a Smooth Transition

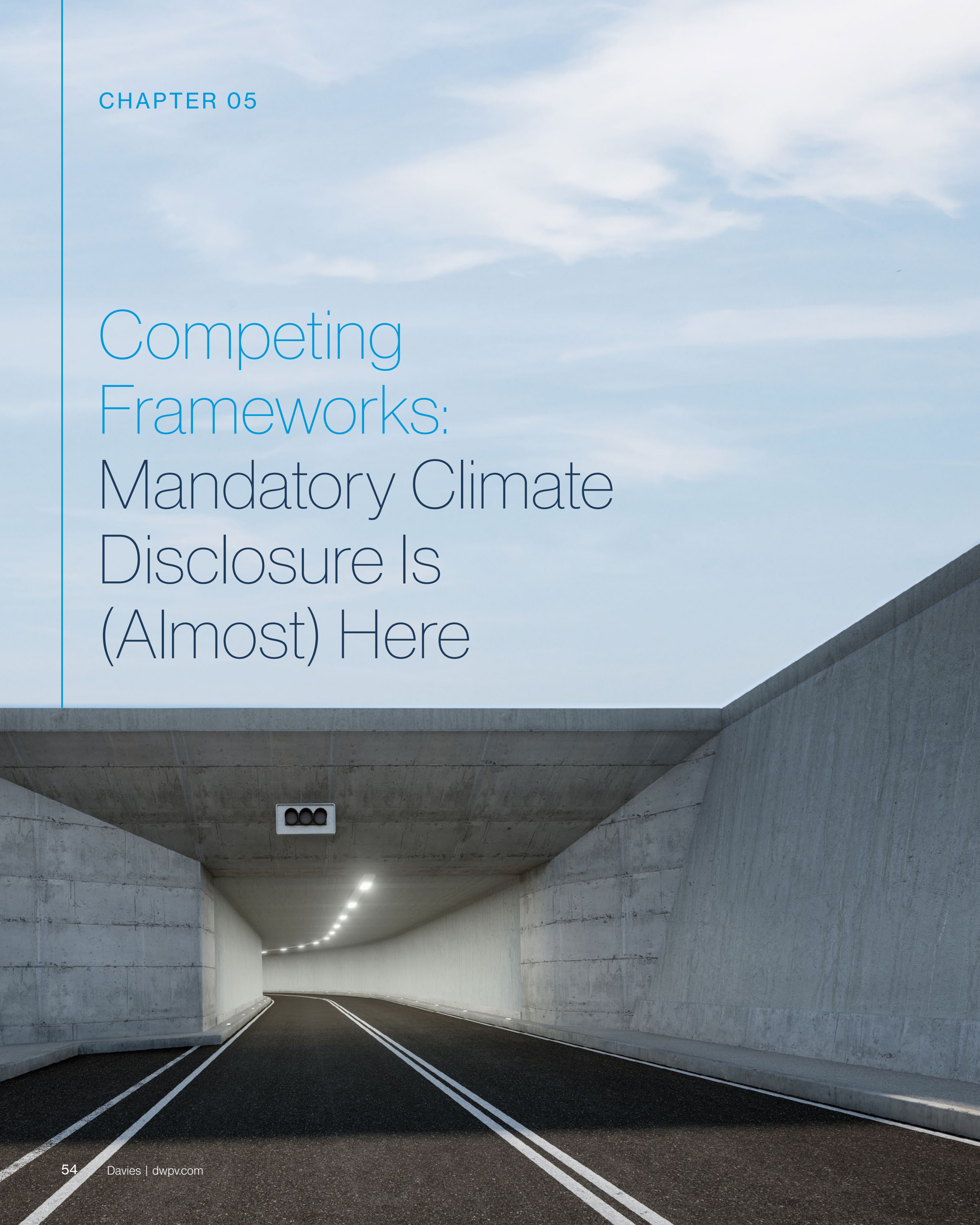
1 **Review general bylaws and articles, and update where appropriate.** CBCA issuers should consider updating their bylaws to reflect the new voting regime, including to formalize the concept of the temporary holdover director. Issuers should also be mindful of their required number of directors and board quorum thresholds.

2 **Review material contracts for provisions triggered by board changes.** Although the grace period for unelected incumbent directors to continue in office is a needed allowance, issuers should proactively review the terms of their material arrangements to identify which terms (such as termination, defaults or payment acceleration), if any, may be triggered by potential board changes under the new CBCA regime. Where possible, issuers may look to amend those terms to include exceptions for changes arising from a majority vote in an uncontested election, and should certainly be thinking about such terms in future arrangements.

3. **Create and refresh your evergreen lists.** The grace period for holdover directors to continue in office is limited to a maximum of 90 days. For many Canadian boards, identifying and recruiting a qualified candidate in such a short period will prove challenging. For that reason, we recommend that boards carefully consider formalizing evergreen lists and director identification, selection and nomination policies to ensure they can act swiftly and consistently if one or more directors fail to receive majority shareholder approval for their election. The board should carefully consider the role unelected directors play on the board during their holdover period. A holdover director may prove a valuable resource in transitioning files to the successor director, but in many cases an unelected director's participation in the deliberations and operations of the board should be reduced or eliminated.

4. **Assess board and shareholder engagement practices.** A board should not take the outcome of an uncontested election for granted (if it ever did). We recommend that boards carefully consider their practices relating to board and committee meeting attendance, director skill and assessment, overboarding and director–shareholder engagement. These practices will be critical to maximize shareholder support for incumbent nominees to avoid situations in which directors fail to receive sufficient votes for re-election, including in the face of against campaigns. Indeed, boards should consider engaging with shareholders well in advance of annual general meetings to solicit their views on the board's composition and its members' relative strengths, skills and abilities. A well-considered engagement policy will continue to be a necessary and effective governance tool. Issuers may also look to routinely engaging proxy solicitation agents to assist in generating support for their nominees.

5. **Update disclosure.** For the 2023 proxy season, CBCA public corporations will need to update their circular disclosure to account for the new regime. For TSX-listed issuers, hopefully aided by further guidance from the TSX, this will mean updating existing TSX majority voting disclosure with details on the new regime. CBCA issuers listed on other exchanges will need to turn their disclosure pens to majority voting for the first time. Where appropriate, CBCA public corporations may also want to include disclosure on the new risks to board stability created by true majority voting.



CHAPTER 05

Competing Frameworks: Mandatory Climate Disclosure Is (Almost) Here

The days of voluntary climate disclosure are numbered, as evidenced by recent domestic and international proposals for mandatory climate disclosure, G7 leaders expressing support for mandatory disclosure and several key jurisdictions having already completed the transition to a mandatory disclosure model. Less clear is whether the Canadian Securities Administrators (CSA) will move forward with recently proposed climate disclosure rules or opt to ratchet up the stringency of its proposal to align more closely with those proposed by the U.S. Securities and Exchange Commission (SEC) or the International Sustainability Standards Board (ISSB).

Our review of climate disclosure provided by the top 18 global mining companies in 2022 (2022 Review) makes clear that the mining sector is relatively well-positioned to satisfy the CSA's proposed rules, but would likely have some work ahead of it to comply with the more robust draft SEC or ISSB rules. Doing so may prove challenging, given that the gap between the Canadian and international proposals is likely to close in the near future. That being said, and as discussed in detail in this chapter, the draft SEC rules may face significant hurdles and delays, meaning that the CSA may need to finalize the Canadian rules while the corresponding U.S. rules remain in limbo.

The Rising Tide of Voluntary Disclosure

As reported in the 2020 edition of *Davies Governance Insights*, the Task Force on Climate-related Financial Disclosures (TCFD) is currently the predominant voluntary climate disclosure framework. According to the TCFD's most recent status report, as of October 2021, the TCFD had over 2,600 supporters (including 1,069 financial institutions), spanning 89 countries, with the following eight jurisdictions having announced TCFD-aligned mandatory reporting requirements: Brazil, the European Union, Hong Kong, Japan, New Zealand, Singapore, Switzerland and the United Kingdom.

In light of such widespread and ever-increasing support for the TCFD framework, both issuers and investors generally view TCFD-aligned disclosure as the key benchmark against which to measure both the quality and the quantity of an issuer's climate-related disclosure.

It was precisely this benchmark that was used in the 2022 Review, which was aimed at evaluating the extent to which such disclosure complied with the TCFD framework. Compared with our similar review of such climate disclosure since 2020, the 2022 Review confirmed that the mining sector has made impressive progress in improving both the quality and the quantity of climate disclosure, and in aligning that disclosure with the TCFD framework.

Taking just two examples that are commonly viewed as the more onerous elements of the TCFD recommendations, the 2022 Review identified a significant increase in the number of reviewed issuers that have undertaken scenario analysis (83% compared with 63% the previous year), a modelling tool used to analyze how specific climate-related risks, both physical and transition, may affect an issuer's business, strategy and financial performance. Scenarios typically used in this analysis include (i) a baseline scenario, in which the world follows a path consistent with existing climate policies; (ii) a "below 2˚C" scenario, in which collective global action is taken to reduce greenhouse gas (GHG) emissions to a target of below 2˚C by 2100; (iii) a "below 2˚C delayed" scenario, in which collective action to align with a target below 2˚C begins only in 2030; and (iv) a "net-zero 2050" target, in which collective global action is taken to reduce GHG emissions to a 1.5˚C target.

Second, the 2022 Review also showed improvement in the disclosure of GHG emissions that may be (i) the direct result of the issuer's operations (Scope 1 Emissions); (ii) the result of the issuer's use of energy (Scope 2 Emissions); or (iii) the result of upstream and downstream activities (Scope 3 Emissions), which

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include emissions from the extraction and production of purchased materials and fuels, outsourced activities, waste disposal or transport-related activities in vehicles not owned or controlled by the issuer. For the 2021 reporting year, 67% of reviewed issuers – up from 58% the previous year – reported their Scope 3 Emissions, the most challenging type of emissions to quantify.

The Canadian Approach to Mandatory Climate Disclosure

In October 2021, the CSA released for public comment proposed National Instrument 51-107 – *Disclosure of Climate-related Matters* (CSA Proposal), aimed at improving the consistency and comparability of climate disclosure and aligning Canadian disclosure standards with the expectations of international investors and, more generally, assisting investors in making informed investment decisions.

Currently, Canadian securities law requires issuers to disclose any material information, including climate-related information. The CSA Proposal imposes a more stringent disclosure requirement, calling for the disclosure of certain climate-related information, even if such information is not material.

The climate disclosure rules set out in the CSA Proposal are, for the most part, aligned with the recommendations of the TCFD. More specifically, the CSA Proposal follows the TCFD in calling for disclosure to be made under four key categories – governance, strategy, risk management, and metrics and targets.

The CSA Proposal departs from the TCFD framework in two key respects. First, the CSA Proposal would not require issuers to undertake scenario analysis, whereas the TCFD recommends that this analysis form part of issuers' disclosure strategy.

Second, unlike the TCFD framework, which calls for the disclosure of Scope 1 Emissions and Scope 2 Emissions and encourages the disclosure of Scope 3 Emissions, the two options the CSA is currently considering would instead require issuers either

– to disclose Scope 1 Emissions, Scope 2 Emissions and Scope 3 Emissions or explain why no such disclosure was made; or

– to disclose Scope 1 Emissions and either disclose Scope 2 Emissions and Scope 3 Emissions or explain why no such disclosure was made.

While scenario analysis has historically been viewed by issuers as one of the most challenging aspects of climate disclosure, the results of the 2022 Review suggest that the private sector is making strides in this area, and that most, but certainly not all, issuers will be in a position to undertake and report on scenario analysis either immediately or in the near term. Prior to finalizing the proposed rules, the CSA will likely consider whether to maintain this departure from the TCFD framework (which would be inconsistent with global trends) or whether it can fashion a rule that is both consistent with the TCFD recommendations, while also allowing issuers to get up to speed – for example, a rule that mandates scenario analysis subject to a grace period.

The CSA's proposed "comply or explain" approach to GHG emissions disclosure is similar to the approach taken in National Instrument 58-101 – *Disclosure of Corporate Governance Practices* regarding an issuer's disclosure of its policies (or the lack thereof) concerning the identification and nomination of women on boards, and the manner in which the issuer's board or nominating committee considers the level of representation of women on the board in identifying and nominating board candidates. It is difficult to predict what approach to GHG emissions disclosure the CSA will ultimately select because both of the foregoing options represent significant departures from the TCFD recommendations and will thus likely fail to satisfy stakeholder expectations. For example, the first option affords issuers an opportunity not to disclose even Scope 1 Emissions – arguably now viewed as table stakes, given the current level of voluntary climate disclosure – whereas the second option arguably fails to recognize the significance of Scope 3 Emissions, which typically far outweigh an issuer's direct emissions, and which are falling under ever-increasing scrutiny by investors. That being said, we would not expect the CSA to require mandatory Scope 3 Emissions disclosure at this time because not all issuers are currently in a position to make such disclosure, as the requisite data remain both difficult and costly to collect, measure, compile and verify.

The View from Afar: A Higher International Standard

While a comprehensive overview of the SEC's proposal for *The Enhancement and Standardization of Climate-Related Disclosures for Investors* (SEC Proposal) and the ISSB's draft *IFRS S2 Climate-related Disclosures* (ISSB Proposal) is beyond the scope of this chapter, it is important to understand the manner in which the two international proposals go beyond the demands of the CSA Proposal, given that the CSA has made it clear that it will continue to monitor international developments and that such developments will inform its approach to climate disclosure.

With regard to the disclosure of GHG emissions, the disclosure mandated under the SEC Proposal and the ISSB Proposal is more closely aligned with the TCFD framework than the corresponding rules in the CSA Proposal. Both the ISSB Proposal and the SEC Proposal would require issuers to disclose both Scope 1 Emissions and Scope 2 Emissions, as well as Scope 3 Emissions, where material. The SEC Proposal would also require the disclosure of Scope 3 Emissions when the issuer has set a Scope 3 Emissions-reduction target or goal.

To address issuers' concerns regarding potential liability associated with Scope 3 Emissions disclosure (which would likely include data and information gathered by third parties in the issuer's supply chain), the SEC Proposal includes a targeted safe harbour for the disclosure of Scope 3 Emissions. The proposed safe harbour would provide that the disclosure of Scope 3 Emissions by or on behalf of an issuer would be deemed not to be a fraudulent statement unless it was made or reaffirmed without a reasonable basis or the disclosure was not made in good faith. That approach strikes a suitable balance between promoting the disclosure of Scope 3 Emissions, while recognizing that, over the near term, such disclosure will include data that the issuer may have had no part in collecting, quantifying or verifying.

Unlike the CSA Proposal, both the SEC Proposal and the ISSB Proposal mandate disclosure in respect of any internal carbon price used by an issuer. Although the SEC Proposal does not require issuers to set climate targets or goals, or undertake scenario analysis, it does mandate disclosure of any such targets, goals or analysis that issuers may have set or completed – a requirement that aligns with the TCFD framework. By contrast, the ISSB Proposal requires issuers to complete and disclose their scenario analysis unless they are unable to do so, in which case they would still be required to disclose why they were unable to do so. Similarly, the ISSB Proposal requires issuers to make detailed disclosure of (i) their plans to transition to a lower-carbon economy and associated climate targets, including explaining how such targets compare with those established by the latest international agreement on climate change; and (ii) their proposed reliance on carbon offsets to achieve those targets. The SEC Proposal also requires issuers to disclose their anticipated use of carbon offsets and renewable energy credits to achieve their emissions-reduction goals. The CSA Proposal contains no corresponding requirement. The 2022 Review suggests that the mining sector generally may still have some work to do in this regard, since only 55% of reviewed issuers provided disclosure regarding their strategies or plans to transition to a lower-carbon economy.

It is far from certain that the SEC Proposal will be finalized as currently drafted. The calls for public feedback on the SEC Proposal resulted in over 7,000 responses, a clear indication of the extent of stakeholder interest and a clear sign that the SEC will have much to consider before signing off on the final version of the draft rules. Furthermore, it is worth noting that the future of the SEC Proposal has been cast in doubt by the recent decision of the U.S. Supreme Court in *West Virginia v Environmental Protection Agency*. Although the decision concerned the ability of the U.S. Environmental Protection Agency to regulate GHG emissions, the court's reliance on the so-called major questions doctrine may have set the stage for a similar challenge to the SEC's authority to mandate climate disclosure (this doctrine restricts the ability of federal agencies to create or adopt rules that would have "transformational" effects on the economy). Commentators have also suggested that the SEC Proposal may be challenged on the grounds that not all the information and data required to be disclosed under the draft rules are material from the investor's point of view, and that the SEC is authorized only to mandate the disclosure of information or data that satisfy such a materiality threshold.

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Spotlight: Key Elements of Leading Climate Disclosure Proposals and Frameworks

This table summarizes the key elements of the CSA Proposal, noting where such elements part ways with the TCFD framework, the SEC Proposal, and the ISSB Proposal. Key differences include the CSA's less stringent requirements for reporting upstream and downstream GHG emissions, and the absence of a requirement to consider risks related to different temperature scenarios.

	CSA Proposal
Publication	Governance disclosure to be made in issuer's management information circular, annual information form or management's discussion and analysis, with other disclosure (strategy, risk management, metrics and targets).
GHG Emissions **Scope 1 Emissions:** produced directly by issuer's operations **Scope 2 Emissions:** indirectly resulting from issuer's energy use **Scope 3 Emissions:** other indirect emissions upstream (e.g., extraction and production of inputs, outsourcing) or downstream (e.g., transport and use of products, waste disposal)	Two options are being considered: Option 1: Scope 1 Emissions, Scope 2 Emissions and Scope 3 Emissions, or issuer's reasons for not making such disclosure. Option 2: Scope 1 Emissions and either disclose Scope 2 Emissions and Scope 3 Emissions or explain why no such disclosure was made.
Scenario Analysis Resiliency of strategy, considering different climate scenarios (including global average temperature increase of 2°C above pre-industrial level, or less)	Not required.
Climate/Transition Plans and GHG Emission-Reduction Targets (Regulated or Voluntary)	Disclosure of issuer's climate targets required if material.

SEC Proposal	ISSB Proposal	TCFD
Disclosure to be made in a new "Climate-related Disclosure" section of issuer's annual reports or registration statement.	Disclosure to be made within issuer's financial reporting, with no specific location mandated.	Disclosure to be made within public annual financial filings.
Scope 1 Emissions, Scope 2 Emissions and, if material or if issuer has made an associated reduction target, Scope 3 Emissions.	Scope 1 Emissions, Scope 2 Emissions and, where material, Scope 3 Emissions.	Scope 1 Emissions and Scope 2 Emissions, and encouraged to disclose Scope 3 Emissions.
Disclosure required if issuer has undertaken scenario analysis.	Issuer required to undertake, and report on, scenario analysis unless unable to do so.	Recommended under strategy disclosure to understand how physical and transition risks may affect business, strategy and financial performance.
Disclosure required if issuer has established any climate goals or targets.	Disclosure required regarding issuer's plans to transition to a lower-carbon economy, and associated climate targets, including explaining how such targets compare with those established under the latest international agreement on climate change, and disclosure of issuer's proposed reliance on carbon offsets to achieve those targets.	Disclosure required of organization's plans to transition to a low-carbon economy when the organization (or the jurisdiction in which it operates) has made GHG emissions-reduction commitments.

Our Take: Getting Ahead of Mandatory Disclosure

It is certainly possible that the CSA may opt to chart its own course and require Canadian issuers to provide a level of climate disclosure that is below, but generally consistent with, international standards; however, such a decision would potentially result in inconsistent climate-risk information being provided to investors across jurisdictions. This could undermine the CSA's stated goal of promoting consistent and comparable climate-related information and data. The challenges faced by the CSA on this issue are similar to those that arose during the development of the federal *Extractive Sector Transparency Act*, whereby Canada ultimately opted to move forward, rather than wait for the challenges posed to the corresponding U.S. disclosure rules to be resolved.

The CSA has confirmed that it will continue to monitor international developments regarding mandatory climate disclosure and that one of the stated goals of the CSA Proposal is to align Canadian disclosure standards with the expectations of international investors. It is therefore reasonable to expect that the CSA will, either in the short or the medium term, rethink its approach to climate disclosure in order to move closer to the transparency of the SEC Proposal or the ISSB Proposal. Furthermore, should the CSA Proposal diverge too greatly from the SEC Proposal, the rationale for the SEC's plan to exempt Canadian issuers that rely on the multijurisdictional disclosure system from the disclosure requirements set out in the SEC Proposal (see our comment letter) would be undermined, with the result that cross-listed issuers may have to align their disclosure with the more stringent SEC Proposal.

That being said, it would not be surprising to see the CSA move forward with the current version of the draft rules, given the uncertainty over the timing (and fate) of the SEC Proposal and because the CSA Proposal is generally consistent with international trends and can be viewed as presenting a cost-effective and measured balance between the demand for investor-friendly disclosure and issuer exigencies.

Despite the uncertainty surrounding the future of both the CSA Proposal and the SEC Proposal, Canadian issuers should be assessing their indirect GHG emissions (both Scope 2 and Scope 3), as well as evaluating the physical risks and transition requirements related to achieving any regulated or voluntary GHG emission-reduction targets in different climate scenarios. Furthermore, issuers who are currently required to disclose audited or verified GHG emissions data under any federal or provincial regulatory regime should ensure that any GHG emissions data disclosed pursuant to the CSA's final disclosure rules are consistent with such audited or verified data. Finally, issuers must have suitable processes, procedures and personnel in place to gather and analyze key pieces of climate-related information and data to prepare for the mandatory disclosure requirements that remain on the horizon – but that are fast approaching.

Key Contacts

If you would like to discuss any of the issues raised in this report or receive more information, please contact any of the individuals listed below or visit our website at www.dwpv.com.

Toronto

Patricia L. Olasker

416.863.5551
polasker@dwpv.com

Aaron J. Atkinson

416.367.6907
aatkinson@dwpv.com

Brett Seifred

416.863.5531
bseifred@dwpv.com

Montréal

Franziska Ruf

514.841.6480
fruf@dwpv.com

New York

Jeffrey Nadler

212.588.5505
jnadler@dwpv.com

Contributors

Researching and writing this report is a project undertaken by Davies Ward Phillips & Vineberg LLP and not on behalf of any client or other person. The information contained in this report should not be relied upon as legal advice.

Aaron J. Atkinson
Jonathan Bilyk
Ivana Gotzeva
Jordan Lavi
Michael Lubetsky
Ifechukwude Obiago
Alexandria Pike
Sarah Powell
Derek Ricci
Abilash Sathyakumar
Brett Seifred
Zachary Silver

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TORONTO

155 Wellington Street West
Toronto ON Canada
M5V 3J7

416.863.0900

MONTRÉAL

1501 McGill College Avenue
Montréal QC Canada
H3A 3N9

514.841.6400

NEW YORK

900 Third Avenue
New York NY U.S.A. 10022

212.588.5500

DAVIES WARD PHILLIPS & VINEBERG LLP