

**Ministry of Government Services
Business Law Modernization Project Consultation Document**

Directors' Residency Requirements

The May 11, 2005 Ontario Budget announced that the government will be modernizing Ontario's business laws. This measure was in response to the government's recognition that Ontario's laws are outdated and have fallen behind other Canadian jurisdictions and the U.S.

Reforms are aimed at:

- modernizing the law to reflect current marketplace practices and ensure market efficiency;
- harmonizing the law with other Canadian jurisdictions and the U.S.;
- providing the legal certainty needed by business for investor confidence;
- ensuring an efficient and globally competitive financial market; and
- maintaining Ontario as a leading corporate law jurisdiction in Canada and North America and securing its competitive position globally.

The Ministry of Government Services is launching a consultation for its Business Law Modernization project. The Ministry kindly requests your input, views and feedback on the modernization issue outlined below.

The Ministry has provided some background material and some options for consideration. Respondents are not restricted to consideration of these options only. Please feel free to share any viewpoints and other options that you feel are appropriate.

Please respond by February 10th, 2006, electronically or in writing, to:

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ISSUE FOR CONSIDERATION

Should Ontario maintain, reduce or eliminate the residency requirement for corporate directors in the *Business Corporations Act*?

BACKGROUND

Subsection 118(3) of Ontario's *Business Corporations Act* (OBCA) requires that a majority of the directors of a corporation incorporated under the Act be resident Canadians.

Ontario imposed its residency requirement on corporate directors in 1972, becoming the first Canadian jurisdiction to do so. The provisions were mirrored in residency requirements introduced with the federal *Canada Business Corporations Act* (CBCA). Similar residency requirements were subsequently adopted in the corporate law statutes of Saskatchewan, Manitoba, and Newfoundland. Additionally, British Columbia's *Company Act* required only that a majority of a corporation's directors be ordinarily resident in Canada.

At the time the directors' residency requirements were introduced in Ontario, there was significant debate as to the efficacy of the provisions in addressing the concerns that prompted their introduction. In subsequent years, the practical application of the provisions, combined with amendments in other jurisdictions, have re-opened the debate. As such, the Government of Ontario is taking this opportunity to analyze this issue to determine the appropriateness of reducing or eliminating the residency requirement for corporate directors in the OBCA.

RECENT REFORMS IN OTHER JURISDICTIONS

Federal CBCA

In 2001, the federal government reduced the residency requirement for corporate directors as part of its reform of the CBCA. Rather than a majority, the CBCA requirement for resident Canadian directors was reduced to 25%. Some of the key incentives for change were to give corporations more flexibility in board composition, as well as to enable corporations to appoint the best-qualified people on their boards.

Other Provincial Statutes

In 2005, both Manitoba and Alberta introduced legislation to reform their corporate law statutes. Both Manitoba, in pending amendments to its *Corporations Act*, and Alberta, in amending its *Business Corporations Act*, adopted the CBCA's 2001 reforms by reducing the directors' residency requirements to 25%. They join Newfoundland, which reduced the residency requirements for corporate directors under its *Corporations Act* to 25% in 2004.

In 2004, British Columbia reformed its corporate laws by replacing the *Company Act* with their own *Business Corporations Act*. The new legislation eliminated the *Company Act's* residency requirement for corporate directors entirely. In this respect, British Columbia joined New Brunswick, Nova Scotia, Prince Edward Island, and Quebec as provinces that do not have any residency restrictions on corporate directors. Other than Ontario, Saskatchewan remains the only other province to require that a majority of a corporation's directors be resident Canadians.

REASONS FOR CONSIDERING REFORM IN ONTARIO

Some stakeholders have suggested reform of Ontario's residency requirement for corporate directors be considered because the practical application of the provision may not properly meet the goals for which the provision was originally created.

Stakeholders have also indicated that the Canadian residency requirement creates problems for offering corporations in complying with new Ontario Securities Commission rules requiring independent directors and directors with financial expertise.

In the case of privately-held corporations operating in Ontario, nominal Canadian directors are often appointed to meet the requirements of the OBCA, but all decision making authority is effectively held by non-residents. The nominal directors, however, may be subject to some liability under federal law because the OBCA cannot override such provisions. Corporations can also avoid the requirement by making themselves subject to the laws of British Columbia, New Brunswick, Nova Scotia, Prince Edward Island, or Quebec, which do not have residency requirements.

OPTIONS FOR CONSIDERATION

The Government of Ontario is considering three options to address directors' residency requirements under the OBCA. They are:

1. Maintain the status quo; or
2. Reduce the directors' residency requirement to 25% (CBCA approach); or
3. Eliminate the directors' residency requirement entirely.

Based on internal policy and legal analysis, the following advantages and disadvantages of each option have been identified:

Option	Advantages	Disadvantages
Maintain the status quo	<ul style="list-style-type: none"> • Ensures Canadian control of boards of Ontario corporations. • Promotes corporate accountability as government can enforce provincial statutes against resident directors. 	<ul style="list-style-type: none"> • Corporations can circumvent the requirements by other legal mechanisms. • Higher residency requirement creates increased regulatory burden on corporations. • Corporations may find other jurisdictions' lower residency requirements more attractive for doing business. • Creates problems for offering corporations in complying with the OSC independent director rules. • Discourages incorporation and potentially investment in Ontario.
Reduce the residency requirement to 25%	<ul style="list-style-type: none"> • Ensures Canadian representation on boards of Ontario corporations. • Gives corporations greater flexibility in board composition. • Allows corporation to appoint the best-suited candidates to its board of directors, regardless of residency status. • Promotes corporate accountability as government can enforce provincial statutes against resident directors. • Harmonizes with CBCA and other provincial jurisdictions. 	<ul style="list-style-type: none"> • Corporations can circumvent the requirements by other legal mechanisms. • Reduced residency requirement still creates regulatory burden on corporations. • Corporations may find the absence of residency requirements in other jurisdictions more attractive for doing business. • Discourages incorporation and potentially investment in Ontario.

Eliminate the residency requirement	<ul style="list-style-type: none"> • Gives corporations complete freedom in board composition, allowing for the appointment of the best-suited candidates to boards of directors, regardless of residency status. • Eliminates potential competitive advantage enjoyed by jurisdictions with no residency requirement (British Columbia, New Brunswick, Nova Scotia, P.E.I., or Quebec). • Reduces the regulatory burden on corporations. • Enables offering corporations to better comply with OSC independent director rules. 	<ul style="list-style-type: none"> • Elimination of the residency requirement may adversely affect the ability of the government to enforce provincial statutes on corporations. • Risk of public concern that Ontario corporations are managed by foreign interests.
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Please provide the Ministry of Government Services with your views and opinions on this issue.

Please submit your comments and points of view:

By e-mail to: john.mitsopulos@mgs.gov.on.ca

Or by mail to:

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This is a public review

All materials or comments received from organizations may be used and disclosed by the ministry to assist in evaluating and revising the proposed draft regulations. This may involve disclosing materials, comments, or summaries of them, to other interested parties during and after the public comment period.

An individual who provides materials or comments and who indicates an affiliation with an organization will be considered to have submitted those comments or materials on behalf of the organization so identified.

Materials or comments received from individuals who do not indicate an affiliation with an organization may be used and disclosed to assist the Ministry in evaluating and revising the proposed draft regulation. However, the ministry will not disclose personal information, such as an individual's name and contact details, unless required by law.

If you have any questions about the collection of this information, you can contact:

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