CANADA BUSINESS CORPORATIONS ACT

DISCUSSION PAPER

DIRECTORS' AND OTHER CORPORATE RESIDENCY ISSUES

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EXECUTIVE SUMMARY

DIRECTORS' AND OTHER CORPORATE RESIDENCY ISSUES

The Canada Business Corporations Act (CBCA) has seven residency requirements. Three of the requirements relate to directors' residency, two involve the location of corporate records, one pertains to the location of the registered office, and the last one relates to the location of shareholder meetings. The main concerns have centred around the relevance of the directors' residency requirements.

Directors' Residency Requirements

Two of three directors' residency requirements stipulate that a majority of the directors must be resident Canadians, both on the board and on each committee. The third requires that in order to transact business at a meeting of the board, a majority of the members that are resident Canadians must be present.

These requirements were adopted in the 1970s after years of increased foreign direct investment. They were intended to ensure that the Canadian viewpoint would be expressed in all meetings of directors of corporations controlled by non-resident Canadians. In addition, it was felt that the residency requirements would ensure that local directors are available to account for any outstanding liabilities.

Another reason for adding these requirements to the CBCA was concern over the extraterritorial application of foreign laws. During the early 1970s, the United States attempted to apply its Trading With the Enemy Act to prohibit some Canadian subsidiaries from trading with Cuba. It was believed that requiring a majority of resident Canadians on the board of U.S. subsidiaries would ensure that these subsidiaries were protected from the extraterritorial application of U.S. law. The Cuban trading prohibition was changed in 1992 to focus on ownership of subsidiaries and not on board composition. The Canadian majority requirement appears to no longer have any influence on whether subsidiaries are subject to the extraterritorial application of such U.S. laws.

The residency requirements can be avoided by incorporating in one of the four provinces that do not impose such requirements. A corporation can incorporate in these provinces, carry on business throughout Canada, and avoid both the desired Canadian input to corporate decision-making and the attempt to enhance directors' accountability.

In addition, the directors' residency requirements can be circumvented by using a unanimous shareholder agreement. Under such an agreement, shareholders can transfer to

themselves the directors' duties to manage and supervise the management of the corporation. In doing so, the number of Canadians on the board becomes irrelevant. They no longer have any influence over the corporation's decision-making. Whether this provision is effective in relieving the liability of directors arising otherwise than under the CBCA is not clear and has not been determined by the courts.

Another method of avoiding the decision-making intent of this provision is to appoint directors who have a vested interest in reflecting the objectives of the parent corporation. It is not difficult to appoint as directors people who are related to the corporation, such as parts suppliers, lawyers, accountants, and so on. These people can have a vested interest in reflecting the wishes of the parent corporation.

There is, however, considerable concern that a repeal of the residency requirements could reduce accountability. Directors can be held liable under hundreds of federal and provincial legislative provisions. Enforcement is significantly enhanced by having directors that are residents and citizens of Canada and local assets from which to satisfy a judgement.

Federal regulators have raised concerns about changes to the directors' residency requirement. It has been suggested that having resident Canadians held liable tends to induce directors to comply with the law. The total elimination of the residency requirement could hinder assurance that foreign corporations comply with Canadian legislation.

Federal regulators have also raised concerns that the elimination of the residency requirements could adversely affect the government's ability to collect income tax, GST, unpaid wages and debts and other amounts in those circumstances where directors' liability is relied upon. There should be at least some resident directors in the Canadian jurisdiction to be held accountable in event of a breach, or there should be an acceptable and workable alternative, such as perhaps a system of bonds or guarantees. Provincial regulators likely have similar views.

Despite this, there are a number of arguments for reducing the directors' residency requirements, regardless of whether it is the number of Canadian residents on the board or on committees. A reduction could:

- provide more flexibility to corporations;
- enable corporations to put the best qualified people on their board;
- allow Canadian export-oriented corporations to more easily develop foreign markets by adding foreign directors;
- remove the incentive for corporations to incorporate or continue into a provincial jurisdiction that has no residency requirement; and
- reduce the regulatory burden placed on corporations.

Options which can be considered include:

1- maintaining the status quo;

2- maintaining the majority Canadian citizenship requirement for the board while eliminating the board's quorum requirement and the residency requirement for committees;

3- requiring that the majority of directors be resident in Canada (not requiring citizenship) and eliminate the quorum and committee requirements;

4- reducing the directors' residency requirement to 25 percent and eliminating the quorum and committee requirements;

5- reducing the directors' residency requirement to one resident Canadian and eliminating the quorum and committee requirements;

6- reducing the directors' residency requirement to one resident director (not requiring citizenship) and eliminating the quorum and committee requirements;

7- allowing corporations to either meet the residency requirement <u>or</u> obtain or post a bond or other form of an acceptable guarantee. Also, eliminate the quorum and committee requirements;

8- allowing corporations to either meet the residency requirement <u>or</u> have any foreign or non-resident Canadian directors irrevocably attorn to the Canadian jurisdiction;

9- eliminating the residency requirements and instead incorporating a "community interest" clause which would stipulate that boards of directors should consider the interest of all stakeholders; and

10- eliminating the residency requirements.

<u>Location of Corporate Records</u>

The CBCA now requires that certain corporate records and adequate accounting records be kept in Canada. Some Canadian corporations, however, want to take advantage of storage services offered outside Canada, particularly in the United States. Recently, Ontario adopted a Bill which allows provincially incorporated companies to keep their corporate and directors' records at a place other than the registered office. These records must be made available for inspection during regular office hours at the registered office by means of a computer terminal or other electronic technology. We propose to allow the same under the CBCA.

Registered Office

Presently, the CBCA must have a registered office in Canada. We propose to maintain this requirement in order to ensure that there is a local place for delivery and service of notices and legal documents.

Location of Shareholder Meetings

The CBCA requires that shareholder meetings be held within Canada, unless all the shareholders entitled to vote at that meeting agree to hold the meeting outside Canada. We propose to also allow the meeting to be held outside Canada if the particular place where the meeting will be held is specified in the articles of the corporation.

The recommendations contained in the discussion paper are not in any sense government or even departmental policy. Rather, they are ideas that have come about largely through preliminary discussions with stakeholders across the country. This paper, and the consultations that will follow, are intended to solicit new ideas on how directors' and other corporate residency requirements can be improved. All suggestions are welcome.

CANADA BUSINESS CORPORATIONS ACT

DIRECTORS' AND OTHER CORPORATE RESIDENCY ISSUES

1. INTRODUCTION

[1] The Canada Business Corporations Act (CBCA) now requires that a majority of the board of directors be resident Canadians. This requirement was adopted in the 1970s after nearly fifty years of increased foreign direct investment which was seen by the federal government as calling into question the economic independence of Canada. However some business people have complained that the residency requirement inhibits the ability of globally-oriented Canadian companies to penetrate foreign markets. Others have pointed out that this requirement can also inhibit the inflow of investment to Canada. Furthermore, it makes other jurisdictions more attractive to investors who may feel that the residency requirements inhibit control over their company's decision-making.

[2] Others have pointed out that the residency requirements found in the CBCA provide significant benefits. The residency requirements can help foreign-controlled firms understand the economic, political and social environment of Canada. Reducing or eliminating them could undermine the ability of the federal government to collect unpaid taxes and source deductions. The requirements are said to be an extremely significant ingredient in encouraging the board to ensure statutory compliance and in the enforcement of rights and liabilities under the Income Tax Act and all other legislation providing for directors' liability.

[3] In addition to the directors' residency issue, companies have pointed out that costs could be saved and investment enhanced if corporate records were not required to be stored in Canada. Others have suggested that in today's global market the CBCA restricts their operations by unnecessarily requiring that shareholder meetings be held in Canada.

2. RESIDENCY REQUIREMENTS

[4] There are seven "residency" requirements imposed by the CBCA. Three of the requirements relate to directors' residency, two involve the location of corporate records, one pertains to the location of the registered office, and the last one relates to the location of shareholder meetings. These requirements are listed below.

Directors' Residency

1. A majority of the directors of a CBCA corporation must be resident Canadians.[1]
2. Directors shall not transact business at a board meeting unless a majority of directors present are resident Canadians.[2]
3. A majority of members of each committee of the board must be resident Canadians.[3]

[5] For these three requirements, the CBCA defines "resident Canadian" to mean a Canadian citizen resident in Canada or in certain cases a non-resident Canadian or a (recent) permanent resident.[4]

Corporate Records

4. Under the CBCA, corporate records containing:

    (a) the articles and bylaws,
    (b) minutes of meetings and resolutions of shareholders,

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[1] Canada Business Corporations Act, (CBCA), R.S.C., 1985, c.C-44, s. 105(3). Ss. 105(4) creates an exception for holding corporations which earn less than five percent of gross revenues in Canada. In such cases, only one third of the directors need be resident Canadians.

[2] CBCA, ss. 114(3).

[3] CBCA, ss. 115(2). Ss. 115(1) also requires that, where the powers of the board have been delegated to a committee of directors or a managing director, a majority of the committee members or the managing director must be resident Canadians.

[4] Resident Canadian is defined in section 2 of the CBCA to mean:
an individual who is
(a) a Canadian citizen ordinarily resident in Canada,
(b) a Canadian citizen not ordinarily resident in Canada who is a member of a prescribed class of persons, or
(c) a permanent resident within the meaning of the Immigration Act and ordinarily resident in Canada, except a permanent resident who has been ordinarily resident in Canada for more than one year after the time at which he first became eligible to apply for Canadian citizenship.

For the purpose of paragraph (b), section 11 of the CBCA Regulations lists certain non-resident Canadians (e.g. government employees) as persons of a prescribed class.

(c) copies of a notice of directors and change of directors, and
(d) a securities register

must be maintained in Canada.[5]

5. If the directors' records (which include the accounting records) are maintained outside Canada, "accounting records adequate to enable the directors to ascertain the financial position of the corporation with reasonable accuracy on a quarterly basis" must be available in Canada.[6]

Registered Office

6. The corporation must have a registered office in Canada.[7]

Shareholder Meetings

7. Shareholder meetings must be held in Canada unless the shareholders unanimously agree to hold the meeting outside Canada.[8]

3. DIRECTORS' RESIDENCY (s. 105(3)), (s. 114(3)), (s. 115(2))

A. Background -- Historical Overview

[6] Early federal business corporation laws included a citizenship and residency requirement but they were largely repealed by 1902 (see page 1, Appendix A). In 1975, the CBCA directors' residency provisions were adopted as part of a larger federal government initiative to promote Canadian ownership and control of the economy.

[7] The residency provisions, as passed in 1975, were intended to address concerns about increased foreign direct investment in Canada, investment which started largely in the 1920s and escalated dramatically after the Second World War.

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[5] Either at the registered office (which must be in Canada) or at any other place in Canada: CBCA ss. 20(1).

[6] Again either at the registered office (which must be in Canada) or at any other place in Canada: CBCA ss. 20(5).

[7] [7] CBCA, ss. 19(1).

[8] CBCA, s. 132.

[8] Starting in the 1950s, several studies had been undertaken to examine the issue of foreign investment in Canada. Many of these studies provided recommendations regarding the inclusion of a directors' residency provision in corporate law.

i. Royal Commission on Canada's Economic Prospects

[9] In 1957, the Royal Commission on Canada's Economic Prospects pointed out that:

> ... In the course of the Commission's hearings, concern was expressed over the extent to which our productive resources are controlled by non-residents, mostly Americans. Many Canadians are worried about such a large degree of economic decision-making being in the hands of non-residents or in the hands of Canadian companies controlled by non-residents. This concern has arisen because of the concentration of foreign ownership in certain industries, because of the fact that most of it is centred in one country, the United States, and because most of it is in the form of equities which, in the ordinary course of events, are never likely to be repatriated. ...
>
> At the root of Canadian concern about foreign investment is undoubtedly a basic, traditional sense of insecurity vis-à-vis our friendly, albeit our much larger and more powerful neighbour, the United States. There is concern that as the position of American capital in the dynamic resource and manufacturing sectors becomes even more dominant, our economy will inevitably become more and more integrated with that of the United States. Behind this is the fear that continuing integration might lead to economic domination by the United States and eventually to the loss of our political independence. This fear of domination by the United States affects to some extent the political climate of life in Canada today [1957].[9]

[10] One of the recommendations of the Royal Commission was that foreign-owned concerns "should include on their boards of directors a number of independent Canadians ... We have in mind something of the order of 20 per cent to 25 per cent".[10]

ii. Watkins Report

[11] In 1968, the Report of the Task Force on the Structure of Canadian Industry (the Watkins Report) was presented to the President of the Privy Council. Like the Royal Commission's report,

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[9] Government of Canada, Report of the Royal Commission on Canada's Economic Prospects, Final Report, November 1957, pp. 389-390.

[10] Ibid., p. 393.

the Watkins Report referred to the increase in direct foreign investment and raised some concerns about it. It pointed out that:

> No other country, however, seems prepared to tolerate so high a degree of foreign ownership as exists in Canada.[11]

[12] It also pointed out:

> Incidents of American extraterritoriality and the issuing of American guidelines to direct investment firms have created much apprehension and some new policy initiatives, of which the most notable is Canadian guidelines for foreign-owned firms.[12]

[13] The report recommended:

> There is a need to ensure Canadian participation in the benefits of foreign direct investment and a Canadian presence in the decision-making of multi-national enterprises.[13]

iii. Report on "Foreign Direct Investment In Canada"

[14] In 1972, the Government of Canada published the report on "Foreign Direct Investment In Canada" which brought forward proposals on foreign investment policy. The document addressed the issue of Canadian directors in the context of a number of proposals to improve Canadian control over foreign investment.

[15] With respect to "Mandatory Canadian directorships in all foreign controlled firms", the report indicated:

> ... a number of countries attach some importance to having their nationals elected to the boards of directors of foreign controlled firms in their jurisdiction.
>
> The feeling generally seems to be that this helps the foreign controlled firm to understand the economic, political and social environment of the host country and better to appreciate its cultural distinctions. It may also be intended to help integrate the foreign controlled firm into its host environment and to enable it to contribute more effectively to the local economy.

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[11] Government of Canada, Privy Council Office, Foreign Ownership and the Structure of Canadian Industry, Report of the Task Force on the Structure of Canadian Industry, January 1968, p. 363.

[12] Ibid., p. 384.

[13] Ibid., p. 411.

> The question thus arises whether all foreign controlled firms ought to be required to elect a minimum proportion of Canadian citizens ordinarily resident in Canada to their boards of directors (say one-half). ...[14]

[16] The report suggested that various ways of achieving this objective might exist, such as requiring as a condition of incorporation "that a designated proportion of the directors be Canadian citizens resident in Canada."[15]

iv. Dickerson Report

[17] Despite these recommendations, the 1971 Dickerson report[16], which was the genesis of the enactment of the CBCA in 1975, recommended against any directors' residency requirement. The report pointed out that:

> Canadian industry being what it is, it seems a futile gesture to impose a general requirement that directors of federally incorporated corporations should be citizens or residents of Canada. If, in a particular industry, it is thought desirable as a matter of government policy to insist upon such a qualification, this should be the subject of specific legislation.[17]

v. CBCA Amendments

[18] Notwithstanding the Dickerson report, the CBCA included requirements specifying that resident Canadians must form a majority of the directors, a majority of the members present at any board meeting, and a majority of each committee of the board. The "Detailed Background Papers for the Canada Business Corporations Bill" noted, concerning the requirement that a majority of the directors of a corporation be resident Canadians, that:

> Some of the major initiatives of the government in this area in recent years have been the introduction of the Foreign Investment Review Act (FIRA) [passed in 1973] and the revision of the acts regulating financial intermediaries and some resource corporations to restrict foreign ownership and control. Nevertheless, it was decided that the corporation law could usefully buttress these provisions by ensuring that the Canadian viewpoint

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[14] Foreign Direct Investment in Canada, Government of Canada (1972), pp. 515.

[15] Ibid., p. 515.

[16] Robert W.V. Dickerson, John L. Howard, Leon Getz, Proposals for a New Business Corporations Law for Canada, 2 vols. (Ottawa: Information Canada, 1971), Dickerson report.

[17] Ibid., par. 201, 1:72.

would be expressed in all meetings of directors and committees of directors of corporations controlled by persons who are not resident Canadians.[18] [Emphasis added]

[19] Earlier, an even stronger requirement had been suggested. Bill C-212, introduced in July 1973, originally proposed that officers and other senior employees of a Canadian subsidiary would not be counted in determining whether there was a Canadian majority on the board. This bill also required that the majority of the board be composed of outside directors.[19] However, due to "an extraordinary number of heated, even passionate criticisms",[20] the government removed this additional limitation when it introduced Bill C-29 in October 1974.

[20] As now defined, the residency requirement can be satisfied through the use of inside directors; that is, officers and employees of the corporation and its affiliates. These board members, even if Canadian, have a strong economic incentive (i.e. their job, salary) to conform to corporate policy which may or may not be in the "Canadian" interest.

[21] One must remember that under corporate law directors are required to act in the best interests of the corporation, not necessarily in the best interests of Canada or the community. Courts have recognized the need of the board to consider the impact of its decisions upon interested third parties, including the community or country where business is conducted.[21] Nevertheless, the underlying principle remains that directors may not act contrary to the interests of the corporation to advance the interests of a stakeholder.

B. Corporate Accountability

i. Directors' Liability

[22] The directors' residency requirements were introduced in the CBCA not only to promote Canadian national interests but also to ensure that resident directors are available to be held accountable. In 1972, the Ontario Minister of Consumer and Commercial Relations, the Honourable J. T. Clement, argued in favour of the adoption of a directors' residency requirement for the Ontario Business Corporations Act. He pointed out that:

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[18] Government of Canada, Detailed Background Papers for the Canada Business Corporations Bill, 1975, p. 12.

[19] An outside director is not defined in the CBCA, but it is implied in s. 102 to include a director who is not an officer or employee of the corporation or its affiliates.

[20] House of Commons, Honourable Otto Lang, Minister of Consumer and Corporate Affairs, Second reading speech, Hansard, November 8, 1974, pp. 1203.

[21] For example, see Teck Corporation Ltd. v. Millar [1973] 2 W.W.R. 385 (B.C.S.C.).

> ... my experience has been that ... you must have someone within the jurisdiction of this particular country that you can get to, in the event that there has been any breach. If you have directors of Canadian corporations or Ontario corporations who are resident in the United States or other jurisdictions and they have committed infractions, perhaps even of the Criminal Code but they are not subject to extradition, there is no way we can bring them back to this bailiwick to have justice meted out to them in accordance with whatever legislation may require.[22]

[23] Corporate law attempts to provide an efficient and effective balance between the competing interests of management, shareholders, employees and creditors. In so doing, it provides certain rights of action against the directors. But those rights are only of value if they can be enforced and if there are sufficient assets available to satisfy any judgement in the event of non-payment. Rights without remedies, or at least effective remedies, are not of much value. Whether for corporate or non-corporate law, the directors' residency requirement might facilitate the enforcement of legal obligations.

[24] Directors can be held liable under hundreds of federal and provincial legislative provisions. However, directors are most likely to face liability under the tax (source deductions), employment standards (employee wages) and environment legislation. Some private legal practitioners and government officials have argued that the residency requirements found in the CBCA can help ensure the enforcement of rights and liabilities under these laws and provide local assets from which to satisfy a judgement. The requirements offer an effective device in that the threat of personal liability attaching to a resident Canadian encourages the board to ensure statutory compliance. Resident Canadians who face potential liability for unpaid corporate liability are more motivated to ensure that payments, such as source deductions, are remitted promptly by the company. A residency requirement can foster compliance with statutory requirements.

[25] Federal regulators have raised concerns about changes to the directors' residency requirement. It has been suggested that having resident Canadians held liable tends to induce directors to comply with the law. The total elimination of the residency requirement could hinder assurance that foreign corporations comply with Canadian legislation.

[26] Federal regulators have also raised concerns that the elimination of the residency requirements could adversely affect the government's ability to collect income tax, GST, unpaid wages and debts and other amounts in those circumstances where directors' liability is relied upon. There should be at least some resident directors in the Canadian jurisdiction to be held accountable in event of a breach, or there should be an acceptable and workable alternative, such as perhaps a system of bonds or guarantees. Provincial regulators likely have similar views.

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[22] Legislature of Ontario Debates, the Honourable J. T. Clement, Minister of Consumer and Commercial Relations, November 27, 1972, Official Report, p.4855.

[27] In the case where liability for directors is joint and several, such as liability for wages under the CBCA, regulators and private plaintiffs have the option of pursuing local directors and leaving it to those directors to seek contribution from the foreign directors. This option would not be available if there are no local directors.

[28] In addition to directors' liability, consideration should be given to the liability of officers, employees and agents of the corporation. These individuals can be found liable in other legislation, such as under the environmental laws. In these cases, adequate corporate compliance may not be dependent on having local directors as long as officers, employees and/or agents are resident in Canada.

[29] However, the liabilities are not always the same for directors and the other agents of the corporation. For example, the liability for wages, source deductions and to creditors under common law[23] are imposed uniquely on the directors. In the case of these liabilities, the residency of directors may be more important. Further, the directors' civil liability provisions of the Income Tax Act (ITA) were enacted as a result of difficulties in enforcing section 242 of the ITA. Section 242 imposes penal liability on officers and agents, as well as directors, for offenses under the ITA committed by the corporation. In this regard, it has been suggested that the presence of legislative provisions which provide for the liability of persons other than directors may not in themselves be adequate.

[30] Four provinces -- Quebec, Nova Scotia, New Brunswick and Prince Edward Island -- do not have directors' residency requirements. The only one of these provinces with any substantial tax collection system is Quebec. A study of this issue was recently contracted out by Industry Canada to examine the impact that the absence of residency requirements has had in Quebec on the collectibility of unpaid source deductions and taxes. This study concludes that:

> ... the collection risk posed by the absence of Canadian directors does not appear to be perceived as a major problem by the Quebec Department of Revenue.

[31] This conclusion was qualified by the fact that it was only in 1992 that the Act Respecting the Ministère du Revenu was changed to hold directors liable for unpaid corporate source deductions and provincial sales tax. Between 1986 and 1992, directors had been liable only for amounts that had been deducted or collected but that had not been remitted. Given this, it is probably no surprise that the Department has had limited experience enforcing its legislation against directors.

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[23] Traditionally, the common law has narrowly limited the directors' fiduciary duty and duty of care as being owed solely to the corporation. The common law of other countries has been broadening the persons to whom duties may be owed to include the shareholders and creditors when the corporation is insolvent. It is not clear whether the Canadian courts are prepared to follow these developments in other countries.

ii. Corporate Governance

[32] While a residency requirement buttresses collection and compliance mechanisms used by government, it can be argued that the requirement is contrary to corporate law policy of seeking good governance of CBCA corporations. Good corporate governance suggests that directors should be selected not to satisfy regulatory concerns but rather to bring expertise to a corporation. Shareholders should have a free hand to locate the best people to cope with corporate situations and not have to place people on their boards primarily because of their place of residence.

iii. Service of Notices and Legal Documents

[33] Another related issue is the service (notification) of administrative proceedings and court actions. When directors are being sued personally, service on directors is also required. Without a residency requirement, some corporations may decide not to appoint any resident Canadian directors and service on these foreign directors is likely to be more difficult than service in Canada.

[34] There are several options for service of notices and legal documents on a foreign director. One option for service on foreign directors would be to allow service on them at their corporations' registered office in Canada.

[35] Another option is found in the Australian Corporations Law. Foreign corporations registering to do business in Australia are required to have a local agent.[24] The local agent is not only responsible for accepting service of legal documents for the corporation but also "is answerable for the doing of all acts, matters and things that the foreign company is required by or under the [Corporations Law] to do". The agent may also be personally liable for a penalty imposed on the foreign company for a contravention of the Corporations Law.[25]

C. Extraterritorial application of foreign laws

i. Background

[36] Another factor in the introduction of the directors' residency requirements was the extraterritorial application of foreign laws. This application occurs when a state asserts

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[24] Australian Corporations Law, s. 345.

[25] Australian Corporations Law, s. 348.

jurisdiction over activities that occur outside its territory but affects its economy or other interests.[26]

[37] The 1963 Cuban Assets Control Regulations,[27] passed under the U.S. Trading with the Enemy Act, prohibited the subsidiaries of U.S. corporations from trading with Cuba. (see Appendix D for details.) Anyone caught violating a provision of the Act could be fined or imprisoned.

[38] In 1974, this Act affected a couple of Canadian subsidiaries. In the spring of 1974, it appeared that the U.S. Government was about to block a sale of locomotives to Cuba by MLW Worthington Ltd. of Montreal, a subsidiary of Studebaker-Worthington of Harrison, N.J.[28] It has been suggested that the two U.S. directors on the subsidiary's board of directors only avoided violating U.S. law by voting against the sale.

[39] In another case, in December 1974, a Canadian subsidiary manufacturing company, Cole Division of Litton Business Equipment Ltd., was unable to carry out an order for the sale of furniture to Cuba. At the time, the directors of the Canadian subsidiary of Litton were U.S. citizens and residents. Apparently, Washington did not block the deal but, since the parent company, Litton Business Equipment Ltd., heavily depended on U.S. defense contracts, they chose to interpret the law literally rather than risk trouble with Washington.[29]

[40] Both cases were referred to when the CBCA was being considered for adoption. One newspaper article indicated that the CBCA directors' residency provisions were proposed because of the Worthington case. The article also suggested that these residency rules would block the application of foreign laws in the Litton-type situation.[30]

[41] Under changes to the U.S. regulations in 1975 and 1977,[31] trade between U.S.-owned and U.S.-controlled firms and Cuba was permitted "where local law requires, or policy in the third country favours, trade with Cuba". However, several conditions were imposed. One of them was that "the affiliate must be generally independent, in the conduct of transactions of the type for

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[26] Investment Canada, Extraterritoriality in the 1990s, Working Paper Number 15, 1993, p. i.

[27] 31 C.F.R. 515.541.

[28] "Ottawa to fight ban on Canadian sale to Cuba", The Globe and Mail, December 24, 1974, pages 1-2.

[29] Time, The Weekly Magazine, Vol. 105, no. 1, p. 35, January 6, 1975.

[30] "Ottawa to fight ban on Canadian sale to Cuba", The Globe and Mail, December 24, 1974, page 2.

[31] 31 C.F.R. 515.559(b).

which the license is being sought, in such matters as decision-making, risk-taking, negotiation, financing or arranging of financing, and performance".[32] The residency of the directors of the subsidiary board may have impacted on the issue of whether the subsidiary was "generally independent" and had independent "decision-making". Therefore, board membership and the requirement for a majority Canadian board may well have influenced whether this U.S. law applied to a Canadian subsidiary of a U.S. corporation.

[42] The Cuban Democracy Act of 1992, passed on October 23, 1992,[33] essentially repealed the 1975 and 1977 regulations permitting U.S. subsidiaries to trade with Cuba. This more restrictive regulation prohibits any "U.S.-owned or controlled firms" and any officer, director or agent of the subsidiary from trading with Cuba.[34] The term "U.S.-owned or controlled firms" does not appear to be defined but focuses on ownership and not how the board is structured.

[43] Objections to this law were made by the governments of Canada, Cuba, the United Kingdom, the European Community and the United Nations and others. In response to the Cuban Democracy Act of 1992, an order was issued under the Canadian Foreign Extraterritorial Measures Act[35]("FEMA"). Enacted in 1984, FEMA has been described as "a remarkable piece of legislation, the culmination point of an often-expressed frustration which Canadians have experienced through the extraterritorial application of American laws in Canada."[36]

[44] Under FEMA, the Attorney General of Canada can make an order protecting Canadian interests from foreign extraterritorial laws. Orders may be enforced through criminal proceedings where the maximum penalties for failing to comply with the order of the Attorney General is $10,000 or 5 years in jail.

[45] In 1992, the Attorney General issued an order[37] under section 5 to nullify the effect of the Cuban Democracy Act of 1992. The effectiveness of this order, however, has been questioned.[38] A number of investigations have been turned over to the R.C.M.P., but no prosecutions have resulted.

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[32] S. 515.559(d).

[33] Title XVII of the National Defense Authorization Act for the Fiscal Year 1993, Public Law 102-484, ss. 1701-1712.

[34] 31 C.F.R. 515.559(a).

[35] R.S.C. 1985, c. F-29.

[36] Graham, "The Foreign Extraterritorial Measures Act" (1986) 11 Can. Bus. L.J. 410, at p. 410.

[37] SOR\92-584.

[38] See discussion in Appendix D.

ii. Analysis - Implications for CBCA residency requirements

[46] In a few rare instances, application of a foreign law may depend upon directors' residency. In general, however, jurisdiction is claimed on basis of ownership and control of subsidiaries and not the management. Since the enactment of the Cuban Democracy Act of 1992, the application of U.S. laws respecting trade with Cuba, the most acrimonious area of extraterritorial dispute between Canada and the U.S., has clearly not depended on the residency of directors. That Act prohibits any "U.S.-owned or controlled firms" from trading with Cuba. That term does not appear to be defined but it focuses on ownership and not on how the board is structured.

D. Provincial Laws

[47] In Canada, six provincial business corporations statutes have directors' residency requirements.[39] Five of the provincial statutes have provisions similar to those in the CBCA, requiring that a majority of directors be "resident Canadians". They are the Ontario,[40] Alberta,[41] Saskatchewan,[42] Manitoba and Newfoundland business corporations statutes.

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[39] Several other federal laws, such as the Bank Act, in certain sectors of the economy require a majority or two-thirds of the directors to be resident Canadians. The Bank Act, S.C., 1991, c. 46, requires:

> At least one half of the directors of a bank that is a foreign bank subsidiary and at least three quarters of the directors of any other bank must be, at the time of each director's election or appointment, resident Canadians.

Similar provisions are found in the Trust and Loan Companies Act, S.C. 1991, c. 45, the Insurance Companies Act, S.C. 1991, c. 47, and the Cooperative Credit Associations Act, S.C. 1991, c. 48. However, these laws apply to specific financial corporations, e.g., banks, and are thus not relevant to the discussion at hand.

[40] Ontario was the first jurisdiction to adopt a directors residency requirement. It came into force, October 1, 1972.

[41] The legislative histories of the enactment of the Ontario and Alberta directors' residency requirements are set out in Appendix A.

[42] Section 100 (3) of the Saskatchewan Business Corporations Act requires that a majority of directors be resident Canadians. Section 100 (3.1) specifies that if none of the directors reside in Saskatchewan, the corporation shall appoint an attorney pursuant to s. 268 and comply with s. 268 as if the corporation is an extra-provincial corporation.

[48] The British Columbia Company Act simply requires that a majority of directors must be "persons ordinarily resident in Canada".[43] In addition, British Columbia also requires that at least one director must reside in the province.[44]

[49] On the other hand, Quebec and the three Maritime provinces do not impose any limitations on the residency of directors.[45] Any corporation can incorporate in these provinces and still carry on business throughout Canada. As such, they can avoid the residency requirements found under the CBCA. For a new corporation, there is no additional cost to incorporate in these regions as opposed to the federal level. For corporations already incorporated under the CBCA there are some legal and other costs associated with a continuance into the Maritimes or in Quebec.

[50] We have been advised that some foreign corporations have incorporated in the Maritime provinces in order to avoid the CBCA residency requirements. Apparently, they have done so largely because they want to maintain a large percentage of foreigners on their board of directors; they do not want to have a board that is greater than 50 percent Canadian residents.

[51] Despite this, there is no evidence to suggest that many CBCA corporations are moving to Quebec or the Maritimes in order to avoid residency requirements. As shown in Table 1, the adoption of the directors' residency requirements has not caused a dramatic flow of new incorporations or continuances away from the CBCA or the six provincial business corporation laws that have residency requirements. Perhaps this has been influenced by the fact that a parent corporation of a wholly-owned subsidiary can effectively avoid the intent of the residency requirement by using a unanimous shareholder agreement.

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[43] British Columbia Company Act, ss. 133(1).

[44] British Columbia Company Act, ss. 133(2). Saskatchewan repealed a similar requirement in 1992.

[45] The Yukon Business Corporations Act and the Northwest Territories Companies Act do not have residency requirements for directors.

Table 1 **Incorporations in Canada (1975, 1985, 1994)**[46]

	1975	1985	1994[47]
Jurisdictions with a residency requirement (Federal, B.C., Alta, Sask., Man., Ont., Nfld.)	78%	81%	78%
Jurisdictions without a residency requirement (Que., N.S., N.B., P.E.I.)	22%	19%	22%

E. Unanimous Shareholder Agreements

[52] Through a unanimous shareholder agreement,[48] shareholders can restrict the powers of the directors to manage and supervise the management of the corporation. Under such an agreement, the shareholders transfer the directors' powers to themselves. It should be noted that s. 146(5) of the CBCA provides that directors are relieved of "their duties and liabilities" to the extent that the rights, powers and duties have been restricted and transferred to the shareholders. It seems clear that the directors may be at least relieved of liabilities arising under the CBCA.

[53] Whether this provision is effective in relieving the liability of directors arising otherwise than under the CBCA is not clear. Most legislation imposing liability on directors requires some degree of active participation in the wrong, or at least a failure to exercise "due diligence" to prevent its occurrence. This would suggest that a nominee director might succeed in a defence based on the argument that the existence of a duty to exercise reasonable care presupposes the power to act on that duty. However, as far as we are aware, there is no case law on point.

[54] The main objective behind the residency requirement, that of giving resident Canadians a say in corporate decisions, can therefore be avoided by wholly-owned subsidiaries in Canada, or at least by the parent corporations. Therefore, many corporations that were intended to be covered by the residency requirement can avoid it. With a unanimous shareholder agreement, a Canadian board is still required (with a majority of resident Canadians) even though all the powers of the board have been transferred to the shareholders.

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[46] R.J. Daniels, Should Provinces Compete? "The Case for a Competitive Corporate Law Market", McGill Law Journal, Vol. 36, (1991) p.158.

[47] The 1994 data were compiled in April 1994 by the P.E.I. government for the Canadian Association of Corporate Law Administrators.

[48] CBCA, ss. 146(2).

[55] In Canada, among the Financial Post (1994) Top 500 corporations:

- There are 238 (47.6%) corporations incorporated under the CBCA.[49]
- Of those 238 corporations, 114 (47.9%) are foreign-owned corporations.
- Of those 114 foreign-owned corporations, 82 (71.9%) are wholly-owned corporations.

[56] Thus, among the 238 CBCA corporations in the 1994 Financial Post Top 500, more than one third (34.4%) are subsidiaries wholly-owned by foreigners. These CBCA corporations generated more than $87 billion in revenues in the Canadian economy.

[57] We have no statistical evidence on the extent to which privately-held corporations, large or small, are using unanimous shareholder agreements. However, we know that unanimous shareholder agreements are being used.[50]

F. Other Mechanisms

[58] In addition to using unanimous shareholder agreements, parent corporations can also appoint figurehead or nominee directors or select "as directors Canadians who lack the nationalism of the statute's draughtsmen".[51] It is not difficult to appoint as directors people who are related to the corporation, such as parts suppliers, lawyers, accountants, and so on. These people can have a vested interest in reflecting the wishes of the parent corporation.

[59] This point was recognized during discussions on the residency issue that were held during the early 1970s. In the second reading debate in 1972 on changes to the Ontario Business Corporations Act requiring a majority of Canadian residents on the board of directors, one member of Ontario Legislature said:

> ... that this is a completely meaningless gesture; that there is no problem at all if Americans, or other aliens, want to keep control of Ontario companies. It is the easiest thing in the world to have the director nominally a Canadian... .[52]

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[49] If Crown corporations and cooperatives are excluded from the top 500, then CBCA corporations would comprise 51.9% of the remaining corporations.

[50] Industry Canada is preparing a discussion paper on unanimous shareholder agreement.

[51] Francis H. Buckley, Corporations Principles and Policies, 2nd ed. (Toronto: Edmond Montgomery, 1988), p. 372.

[52] Legislature of Ontario Debates, the Honourable V. M. Singer, M.P. Downsview, November 27, 1972, Official Report, p.4848.

[60] This was also recognized by the federal government in its 1972 report on Foreign Direct Investment in Canada. There, it was pointed out that:

> The election of directors in itself is not a step of great significance. The Canadian director can simply be the figurehead for the parent company's management or he can be someone of independent strength and standing.[53]

[61] In 1985, the Macdonald Commission Report pointed out that:

> ... federal and provincial company laws do not, however, impose any particular duties or requirements on Canadian directors to ensure that a Canadian, as compared to a foreign, viewpoint affects corporate decision making.[54]

[62] Indeed, as mentioned before, under corporate law, directors are required to act in the best interests of the corporation, not necessarily in the best interests of Canada or the community.

G. Committees

[63] The above-mentioned mechanisms apply to members of committees that have been established to perform specific duties, such as the audit committee. In addition, committees do not even have an effective majority residency requirement. There is a requirement that a majority of committees members be resident Canadians. However, there is no requirement that a quorum of resident Canadian committee members be present at any particular meeting for business to be conducted. Thus, it is possible to have committees whose membership is composed of a majority of resident Canadians, but who conduct meetings and transact business without any Canadians present at all.

H. Evidence of Over-compliance

[64] One question is whether the residency requirements have been necessary in promoting Canadian interests through inducing higher Canadian representation in the boardroom and corporate decision-making which is more reflective of Canadian interest.

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[53] Foreign Direct Investment in Canada, published by the Government of Canada (1972), page 516.

[54] Report of the Royal Commission on the Economic Union and Development Prospects for Canada, 3 vols., 1985, 2:242. The report therefore went on to recommend that "it would be desirable to amend existing company laws to make clear provision obliging Canadian directors to ensure that Canadian interests receive serious and sustained consideration in the making of all important corporate decisions".

[65] Some evidence is available on the membership of Canadian boards. One author has noted that:

> In fact, the proportion of resident Canadians on boards of directors is considerably higher than the majority required by the CBCA. The **Conference Board** reports that the proportion increased from 84% to 87% from 1977 to 1982.[55] [Emphasis added]

[66] The figures in the 1990 Conference Board report are similar to those reported in the 1984 report.[56] These reports surveyed a cross section of generally larger Canadian corporations in the manufacturing and non-manufacturing sectors.

[67] Similarly, in 1991, Korn Ferry International[57] surveyed 107 CEOs of larger Canadian companies and found that only: "Twenty-nine per cent of Canadian boards report having a non-Canadian citizen as a member." Thus, some 70 percent of the boards surveyed had no foreign directors at all.

[68] Internal research by Industry Canada further substantiated that most CBCA corporations greatly exceed the residency requirement. The survey showed that in some 82 percent of the 340 CBCA corporations examined, more than 90 percent of their directors are resident in Canada (see Table 2).[58]

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[55] Francis H. Buckley, Corporations Principles and Policies, 2nd ed. (Toronto: Edmond Montgomery, 1988), p. 372.

[56] John Longair, Canadian Directorship Practices: A Profile 1990, A Conference Board of Canada Report, Report 51-90, March 1990, pp. 15-17.

[57] Korn Ferry International, Report on Boards of Directors -- Fifth Annual Study in Canada, 1991, p. 5.

[58] The Compact Disclosure Canada database was used for the purpose of this study. The database is produced by Micromedia Ltd. and consists of extracted data on more than 8,000 corporations -- federally and provincially incorporated, private and public, mutual funds and crown corporations. Of those 8,000 corporations, only 1,025 contained the specific information needed for the study. The remainder was rejected because their files did not contain the relevant information.

Table 2 Percentage of Directors of CBCA and non-CBCA Corporations Residing in Canada

Percentage of directors residing in Canada	Non-CBCA Corporations	CBCA Corporations	Total
50% to 60%	17	7	24
60% to 90%	125	54	179
90% to 100%	883 (86%)	279 (82%)	1162 (85%)
Total	1025	340	1365

[69] The surveys done by the Conference Board and Korn Ferry International indicate that, for most larger CBCA corporations, the number of Canadian residents directors now exceeds the statutory requirement.[59] As for Industry Canada's study, while information was not available on the citizenship of the directors, the results indicate that the vast majority of directors of CBCA corporations reside in Canada.

[70] Some research has been done that suggests that good management and basic economics may dictate these types of results. Studies conducted in the United States indicate that there is better subsidiary decision-making when the board includes local residents. (Appendix B summarizes the limited work done on this issue.)

[71] In addition, law firms often will advise foreign parent corporations that in order to reduce potential liabilities, the board of directors of their subsidiary in Canada should contain some independent directors who are not affiliated with the parent and are not employed by the subsidiary.

[72] This information seems to suggest that basic financial incentives will even lead Canadian subsidiaries of foreign corporations to appoint Canadians to their board of directors.

I. Globalization

i. Foreign Direct Investment

[73] In contrast to the period when the Foreign Investment Review Act (FIRA) and the CBCA directors' residency provisions were adopted, Canada has developed a global approach to its

[59] As discussed below under the headings "International Requirements" and "Summary", the directors' residency requirement seems to cause the most problems for globally-oriented Canadian corporations and larger foreign-owned subsidiaries.

economic development strategies. This global trend is signified by the recent signing of the General Agreement on Trade in Services (GATS), the Free Trade Agreement (FTA) and the North American Free Trade Agreement (NAFTA).

[74] Federal and provincial governments are trying to create a positive investment climate to attract foreign investment in Canada and create economic growth and jobs. Since 1985, Canadian orientation toward foreign investment has become less restrictive. FIRA has been replaced by the Investment Canada Act.[60] Under this Act, investment by Canadians and non-Canadians is presumed to be of benefit to Canada unless it is shown otherwise.[61] This contrasts with FIRA, under which the level of foreign control was a matter of national concern and all new business as well as direct and indirect acquisitions were reviewed. Also, less restrictive rules have been adopted in key sectors such as financial services and energy.

[75] Another relevant element, in addition to these regulatory changes, is that the flow of investment in the Canadian economy has changed considerably over the last twenty years.[62] The relationship between Canadian direct investment abroad and foreign direct investment[63] in the Canadian economy has become much more balanced. The ratio of outward to inward investment increased steadily from 0.23 in 1970 to 0.72 in 1992.[64] This trend shows that Canadians have become international investors and full participants in the global market.

[76] In addition to a change in foreign direct investment, there has been a change in the foreign-control of corporate assets of Canadian business corporations. The foreign-controlled share of non-financial Canadian corporations decreased dramatically during the past 20 years, going from about 37 percent in the early 1970s to less than 25 percent in 1993. (see Figure 1).[65]

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[60] Investment Canada Act, R.S.C. 1985, c. 28 (1st Supp.).

[61] Investment Counsellor's Handbook, Investment Canada, p. 13, 1987.

[62] Steven Globerman, gen. ed., Canadian-Based Multinationals, (The Industry Canada Research Series, The University of Calgary Press, 1994), Canadian-Based Multinationals: an analysis of activities and performance, by Someshwar Rao, Marc Legault & Ashfaq Ahmad, p. 67.

[63] FDI includes investments made by foreign corporations or individuals for the purpose of owning, controlling, and operating a business.

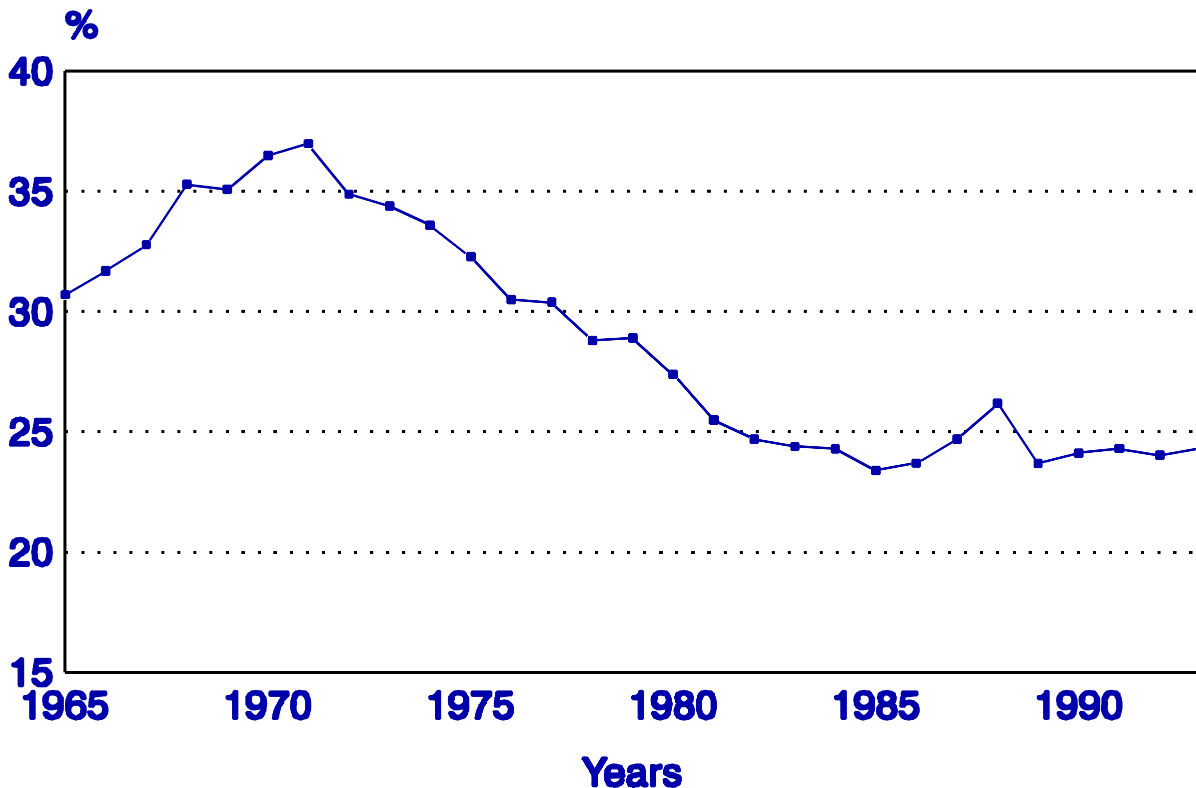
[64] Ibid, p.67. This ratio is the dollar value of investments made abroad by Canadians divided by the dollar value of investments made in Canada by foreigners.

[65] The data used for this study came from the publication: Corporations and Labour Unions Returns Act (CALURA), Statistics Canada, Parliamentary Report, Catalogue 61-210 (1988); and 61-220, Annual (1989, 1990, 1991, 1992). In 1988, the CALURA report introduced data using a new methodology. This created a break in the time series. It is impossible to conclude whether the trend would have been as flat if data for 1988 to 1992 had been obtained using the previous methodology.

FIGURE 1

Foreign-Controlled Share of Corporate Assets

Non-Financial Corporations, 1965-1992



ii. Foreign Directors and Export-Oriented Companies

[77] Analysis carried out for Industry Canada by Statistics Canada indicated that in 1991 about 10 percent of Canadian-controlled corporations obtained more than 50 percent of their total revenues from the export market. Another 7 percent generated between 30 and 50 percent of their total revenues from the export market.

[78] In light of this, we need to ensure that the CBCA does not restrict the ability of Canadian companies to efficiently penetrate foreign markets. Canadian businesses whose primary sales are in the export market claim that they would be better able to penetrate new markets if they could

easily include more people from those markets on their board of directors. Under the CBCA, however, they cannot: the majority of the board has to be Canadian. If a corporation is just meeting this requirement, then at least one Canadian must be appointed to the board every time a foreigner becomes a director. This quickly increases the size of the board beyond an optimal level and imposes costs and inefficiencies on the corporation.

[79] Some people have questioned the importance of having foreign directors on the board of export oriented companies. While there does not appear to be any solid evidence of the importance of this feature, there is some indication that such appointments are important to successful multilateral corporations. For example, a study of corporate governance of five countries recently reported that:

> As companies' operations become more multinational, to the point where they do relatively little business in their country of origin (...) it might be imagined that the board would reflect the international nature of their markets and operations. There does indeed seem to be some evidence that boards in many countries now have more foreigners on them.[66]

[80] Canadian business is developing global markets, capital and expertise. Part of this outward orientation requires obtaining foreign expertise on the boards of directors to attract investors, partners, strategic alliances and access to global markets. In a recent article, the Chairman of SHL Systemhouse Inc. was quoted as saying that SHL, currently a CBCA corporation, needs more directors from around the world to reflect the way it is now doing business.[67]

[81] Overall, during the last three decades, Canadians have invested more abroad and have become relatively less dependent on foreign investment. We have become global players in international capital markets. Sylvia Ostry, a prominent Canadian economist, has pointed out that:

> Canada's economic future will become increasingly dependent on greater investment abroad and new strategies to attract foreign investment... . It is very important for a country like Canada to begin to look at the world through the prism of investment. ... [F]oreign investment and international trade are becoming intertwined.[68]

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[66] Jonathan Charkham, Keeping Good Company -- A Study of Corporate Governance in five Countries, p. 350, Clarendon Press, Oxford, 1994.

[67] Alana Kainz, "Canadian Block Bid to Add Foreigners to Board of Directors," Ottawa Citizen, January 13, 1995, p. F3.

[68] The Financial Post, August 31, 1994, p. 4.

J. Foreign Laws

[82] Very few countries now impose directors' residency requirements. Recently, in a letter to Industry Canada, it was pointed out that:

> ... one should consider the fact that very few jurisdictions impose residency requirements for corporate directors. In Europe, Asia, Australasia and South America one is hard pressed to find examples (other than in Nordic countries and Argentina) where residency is relevant to board qualification. In the United States, ... Hawaii [is the only state] which maintains a residency requirement - and only one member must be a resident [of Hawaii].

[83] Several U.S. state corporate laws (including Arkansas, Florida, Nevada and South Dakota) once required either one director to be a U.S. citizen or a resident of the state. These provisions have been repealed, following the lead of the American Model Business Corporations Act.[69] This Model Act now provides that: "A director need not be a resident of this state or a shareholder of the corporation unless the articles of incorporation or bylaws so prescribe."

[84] As noted above, Hawaii is the only U.S. state with a residency requirement. It used to require one third of the directors of Hawaiian corporations to be state residents. This requirement was reduced to one director over a decade ago.

[85] The General Corporation Law of Mexico has no restriction as to the citizenship nor the place of residence for the members forming the board of directors of any corporation. However, the Foreign Investment Law has some limitations as regards to ownership or management control in Mexican entities. In general terms, foreign investors may directly or indirectly hold all of the capital stock of any Mexican corporation except for those subject to specific statutes or reserved for Mexicans. The same restrictions applicable to capital stock are also generally applicable to management control and, as a result, to the composition of the board of directors. Foreign investment may reach a percentage of participation of up to 10%, 25%, 30% and 49% in various industries. For example, foreign participation is permitted up to 10% in the manufacturing industry, 25% in transportation, 30% in banks and 49% in insurance companies and brokerage houses.

[86] Few European countries have directors' residency requirements. From our research no members of the European Community, including the United Kingdom, France and Germany have any such requirements. It should be noted, however, that some European countries, such as Germany, require worker and union participation on supervisory boards of directors for larger corporations.

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[69] Prentice Hall Law & Business, Editors, Model Business Corporation Act, Adopted by: Committee on Corporate Laws of the Section of Business Law of the American Bar Association, Revised through 1991.

[87] In Germany, domestic banks also typically hold, directly or indirectly, much of the stock of major corporations. As such, they are generally represented on the supervisory board, which supervises the performance of the corporations' managers. Various industrial democracy acts applicable to different categories of corporations generally require that one-half or one-third of the supervisory board consist of employee representatives. These people are typically residents of the country and they have a large influence on corporate decision-making.

[88] The Australian Corporations Law includes directors' residency but not citizenship requirements. A publicly-traded corporation must have at least two persons who ordinarily reside in Australia. A privately-held (or "proprietary") corporation must have at least one person who ordinarily resides in Australia.[70]

[89] Australian officials have stated that the Australian residency requirement was imposed largely to ensure accountability by having a person with assets in the jurisdiction. The concern was not about ensuring a local presence in the boardroom. Officials have also advised us that there has been some reconsideration of the need for these requirements. However, a review of this issue is not part of the current limited round of reform of the Australian Corporations Law.[71]

[90] Overall, a review of foreign rules indicates that a directors' residency requirement is not a common phenomenon. Concerns about corporate accountability are addressed in the corporate laws of other countries through other mechanisms, such as the use of agents, a supervisory board, and perhaps corporate rules such as minimum capital requirements.

K. International Requirements

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[70] Australian Corporations Law, s. 221(3).

[71] As per discussions with staff at the Australian Embassy, Washington. There is no residency requirement imposed on foreign corporations operating in Australia, although such companies must register and must have a local resident agent (person or company, Australian Corporations Act, s. 345). The agent must be authorized to accept service of documents (s. 346) and "(a) is answerable for the doing of all acts, matters and things that the foreign company is required by or under this Law to do; and (b) is personally liable to a penalty imposed on the foreign company for a contravention of this Law if the court or tribunal hearing the matter is satisfied that the local agent should be so liable" (s. 348).

[91] The CBCA provisions correspond with both the General Agreement on Trades in Services (GATS)[72] and the North American Free Trade Agreement (NAFTA). A detailed analysis of the impact on directors' residency of NAFTA is set out in Appendix C.

[92] Article 1107 of NAFTA, entitled "Senior Management and Boards of Directors" in the "Investment" chapter, expressly permits countries to

> require that a majority of the board of directors, or any committee thereof, of an enterprise of that Party that is an investment of an investor of another Party, be of a particular nationality, or resident in the territory of the Party, provided that the requirement does not materially impair the ability of the investor to exercise control over its investment [Emphasis added].

[93] As permitted by article 1108, the Canadian government has listed the residency requirement under the CBCA as an exception to the requirement in article 1107.[73]

[94] It should be noted, however, that under NAFTA, once a measure has been liberalized, such as the residency requirement, it cannot then be made more restrictive.

[95] In terms of the spirit of NAFTA and GATS, the purpose of the agreements is to remove barriers to trade and investment. In this respect, a number of countries with which Canada held bilateral negotiations in the General Agreement on Trade in Services (GATS), raised the issue of Canadian citizenship or residency requirements for boards of directors incorporated federally or in certain provinces. The Japanese, in particular, seemed to view this as a problem, mentioning complaints from Japanese investors, and attempted to characterize such requirements as a flaw in our offer with respect to "Commercial Presence" as a means of delivering a service. Relatively few developed countries aside from Canada would appear to have such measures in place. While GATS negotiations are now concluded, our trading partners may return to this issue in any future negotiations related to liberalization of trade in services.

L. Summary

[72] Article XVII of the GATS makes a commitment to provide national treatment in service sectors covered by the agreement subject to certain conditions and qualifications. Because it was considered that the board of director residency requirements might impose on foreign owned or controlled Canadian incorporated service suppliers treatment "less favourable" than that accorded Canadian owned or controlled suppliers, a qualification on national treatment was listed in the Canadian Schedule to the GATS respecting board of director residency requirements. This qualification provides that a majority of the directors of federally incorporated corporations in Canada must be Canadian citizens or persons ordinarily resident in Canada.

[73] The exception allows Canada to keep the requirement even if it is non-conforming with the agreement.

Incentives for status quo:

[96] From the above, arguments in support of the current directors' residency requirements suggest that they:

- foster Canadian participation in the decision-making of multi-national enterprises;
- help foreign-controlled firms understand the economic, political and social environment of Canada;
- facilitate the enforcement of rights and liabilities under the CBCA and other legislation by ensuring directors are present in Canada;
- foster compliance with statutory requirements;
- facilitate service of administrative proceedings and court actions;
- reduce potential litigation costs by facilitating enforcement and collection; and
- reduce potential losses by government and third parties (e.g., unpaid wages).

Incentives for change:

[97] Other points indicate that changes to the current directors' residency requirements would be beneficial to Canada. A reduction in the current residency requirements for boards and committees could:

- provide more flexibility to corporations regarding board composition;
- enable corporations to put the best qualified people on their board and therefore help maximize profits to shareholders and returns to Canada;
- allow Canadian export-oriented corporations to more easily develop foreign markets by adding foreign directors;
- eliminate the incentive and cost of establishing a unanimous shareholder agreement in cases where a corporation is only seeking to avoid the residency requirement;
- remove the incentive for corporations to incorporate or continue into a provincial jurisdiction that has no residency requirement;
- reduce the regulatory burden placed on corporations; and
- help make federal corporate law more consistent with that found in other countries.

M. Options

[98] There are several possible options for revising the CBCA directors' residency requirements. Some of these options have been suggested by the business or legal communities. Others have been developed by Industry Canada. The range of options is not limited to the following list and any other suggestions will be considered.

Option 1:	Status quo
Option 2:	Maintain the majority Canadian citizenship requirement for the boards, while eliminating the quorum requirement for the board and the committee's residency requirement.
Option 3:	Require that the majority of directors be resident in Canada (not citizens) and eliminate the quorum requirement for the board and the committee's residency requirement.
Option 4:	Reduce the directors' residency requirement to a 25 percent resident Canadian (citizen) requirement and eliminate the quorum requirement for the board and the committee's residency requirement.
Option 5:	Reduce the directors' residency requirement to one resident Canadian (citizen) and eliminate the quorum requirement for the board and the committee's residency requirement.
Option 6:	Reduce the directors' residency requirement to one resident director (require only Canadian residency, not citizenship)[74] and eliminate the quorum requirement for the board and the committee's residency requirement.
Option 7:	Allow corporations to either meet the residency requirement in the CBCA or obtain or post bond or other form of an acceptable guarantee for unpaid debts or other potential liabilities that non-resident directors might face. Also, eliminate the quorum requirement for the board and the committee's residency requirement. The proof of guarantee would probably have to be filed with the Director pursuant to the CBCA.

[74] For instance, we could take the Income Tax Act definition of residency or we could follow the recent changes made in the Ontario Business Corporations Act and amend the definition of resident Canadian to refer to Canadian citizen and permanent resident.

It is not clear whether this option is practicable. Questions remain as to: how the guarantee would change when the asset size of the corporation changes; and whether an acceptable guarantee would have to be negotiated with each potential major creditor.

Option 8: Allow corporations to either meet the residency requirement in the CBCA or have any foreign or non-resident Canadian directors irrevocably attorn to the Canadian jurisdiction.

It is not yet clear whether such an attornment would enable debtors to successfully take an action against non-resident directors.

Option 9: Repeal the residency requirements and insert a "community interest" clause. Require an agent for service of legal documents.

This clause would stipulate that boards of directors could consider the interests of all stakeholders, such as employees, creditors, suppliers, customers, and local communities, and not only maximise the shareholders' value.

The incorporation of this clause, however, could diminish shareholder protection because the business decisions of the directors would have to take into account the interest of other stakeholders. Also, the whole CBCA would have to be reconsidered because such a clause could affect many parts of the Act, such as the take-over bids and insider trading sections.

Option 10: Eliminate the directors' residency requirements. Require an agent for service of legal documents.

Some corporations favour a complete repeal of the directors' residency requirement. However, the requirement for Canadian directors on the board facilitates the enforcement of current laws that hold directors responsible for the payment of certain corporate debts. Some federal departments strongly feel that the collection of unpaid debts would be jeopardized if there is no Canadian residency requirement in the CBCA or if the requirement is significantly reduced.

[99] For any of the previous options that require more than one resident Canadian director or more than one director resident in Canada, that option would also be accompanied by a "two-person board" exemption. Specifically, in the case where a board of a corporation is comprised of two directors, only one of them would be required to be a resident in Canada or resident Canadian.[75]

4. LOCATION OF CORPORATE RECORDS (s. 20)

A. Background

[100] Computer information storage services are now international. Currently, the CBCA requires that certain corporate records and adequate accounting records be kept in Canada.[76] Some Canadian corporations, however, want to take advantage of storage services offered outside Canada, particularly in the United States.

[101] One federal department has expressed concerns about allowing corporate records, particularly accounting records,[77] to be kept outside Canada. Permitting corporate records, including accounting records, to be kept outside Canada may be inconsistent with the Income Tax Act.[78] The Income Tax Act requires that "records and books of accounts"[79] shall be kept in Canada or such other place as may be designated by the Minister of National Revenue (s. 230(1)).

[102] Recently, Ontario adopted Bill 175,[80] which allows provincially incorporated companies to keep their corporate and directors' records off-site "at a place other than the registered office of the corporation if the records are available for inspection during regular office hours at the registered office by means of a computer terminal or other electronic technology".[81] This new

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[75] The "two-person board" provision is already in force under the Ontario Business Corporations Act, ss. 118(3).

[76] See footnotes 5 and 6 above and accompanying text.

[77] Accounting records, specifically referred to in ss. 20(2), are part of the corporate records (ss.20(2)).

[78] Income Tax Act, R.S.C. 1952, c.148, as amended by S.C. 1970-71-72, c. 63, as modified.

[79] We take the terms "books of accounts" and "adequate accounting records" to mean the same.

[80] Statute Law Amendment Act, 1994.

[81] Parliament of Ontario, Bill 175, ss. 71(17) is repealing and replacing s. 144(3) of the Ontario Business Corporations Act.

provision is subject to compliance with other statutes, such as the Income Tax Act, as would be any new CBCA provision.

[103] There may be some concern about adequate access to on-line records. The use of on-line access may be difficult and non-practicable without the assistance of the corporation's employees. A suggestion has been made that any amendment to permit a corporation to hold records outside Canada should be accompanied by a provision expressly obligating the corporation to provide adequate assistance for computer searches.

[104] Currently, a CBCA corporation is permitted to maintain all of its registers and records by computer (s. 22(1)). These electronic registers and records, as well as paper records, must be maintained at a place in Canada. Section 21 permits shareholders, creditors and others to "examine" the corporate records. It might be argued that the authority in s. 21 to "examine" corporate records includes an implied obligation on the corporation to allow access to the records in an accessible manner. However, it is not clear that such an obligation is currently imposed.

B. Recommendation

Adopt the Ontario approach of permitting corporate records to be kept at a place other than at the registered office of the corporation as long as they are electronically "on-line" at the registered office subject to requirements in other legislation.[82] A provision would be included obligating the corporation to provide adequate assistance to any electronic records.

Pros: ! This option allows flexibility in storage while permitting access to records.[83]
! It harmonizes with developments in the provinces (e.g. Ontario).

Cons: ! Access to key documents, such as books of account, may be jeopardized.

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[82] A parallel amendment should also be made to ss. 50(3) which provides for the place of the securities register.

[83] One related matter is proof of copies of such electronic documents -- legislative amendments might also be required to ensure that such copies could be used as evidence on court proceedings.

C. Options

Option 1: Adopt the recommendation and also require that the corporate records be updated periodically.

Option 2: Status quo: maintain the requirement that corporate records and adequate accounting records be kept in Canada.

5. REGISTERED OFFICE (s. 19)

A. Background

[105] At the present time, the corporation must have a registered office in Canada.

B. Recommendation

Maintain the current requirement for a registered office in Canada.

Pros:
! This requirement ensures that there is a local place for delivery and service of notices and legal documents.
! It is a common requirement in all corporate law.

Cons:
! This requirement may prevent a corporation from choosing the optimum location for the registered office and could increase the cost of doing business.

C. Option

Option 1: Allow the registered office to be outside Canada. A provision would be included to obligate the corporation to provide access to the registered office.

6. LOCATION OF SHAREHOLDER MEETINGS (s. 132)

A. Background

[106] The CBCA requires shareholder meetings to be held within Canada unless all the shareholders entitled to vote at that meeting agree to hold the meeting outside Canada (s. 132).

[107] Several provincial laws require meetings to be held in that jurisdiction unless all the shareholders agree or unless the articles specify another place. For example, the Saskatchewan Business Corporations Act provides that "where the articles so provide, meetings of shareholders may be held outside Saskatchewan at one or more places specified in the articles."[84]

[108] A corporation incorporated in Ontario, may hold its shareholder meetings at a place in or outside Ontario as determined by the directors, subject to the articles or any unanimous shareholders agreement.[85] The Quebec Companies Act provides that a publicly-traded corporation must hold its annual meetings in Quebec. A privately-held corporation may hold its annual meetings outside Quebec if its deed or articles of incorporation provides for it or if all shareholders consent.[86]

[109] The British Columbia Company Act requires that: "Every general meeting of a company shall be held in the Province, or at a place out of the Province the Registrar, on application made to him by a company, approves."[87] The British Columbia government's 1991 Company Act Discussion Paper proposes that the new British Columbia Company Act would allow an annual meeting to be held outside the province if the articles of the company specify other locations. The paper points out that: "The members of the company should be able to decide for themselves where its annual meetings should be held, as long as the interests of all the members are protected."[88]

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[84] Saskatchewan Business Corporations Act, R.S.S. c. B-10, ss. 126(3). Similar provincial rules include the Alberta Business Corporations Act, S.A. 1981, c. B-15, ss. 126(4); the Manitoba Corporations Act, R.S.M. 1987, c. C225, ss. 126(3); and the New Brunswick Business Corporations Act, S.N.B. 1981, c. B-9.1, ss. 84(3). The corporate laws of Prince Edward Island and Nova Scotia do not appear to have any requirements respecting location of shareholder meetings. We have not yet had an opportunity to review the corporate law of Newfoundland.

[85] The Ontario Business Corporations Act, R.S.O. 1990, c. B-19, ss. 93.

[86] R.S.Q., c. C-38, ss. 98(1).

[87] British Columbia Company Act, R.S.B.C. 1979, c. 59, ss. 170.

[88] Ministry of Finance and Corporate Relations, Company Act: Discussion Paper, Province of British Columbia, January 1991, p. 58. The Paper provides that under the current Act:

[110] In the United States, the Model Business Corporation Act provides similarly that: "Annual shareholders' meetings may be held in or out of this state at the place stated in or fixed in accordance with the bylaws. If no place is stated in or fixed in accordance with the bylaws, annual meetings shall be held at the corporation's principal office."[89]

[111] A lot of Canadian inter-listed public companies have significant U.S. shareholder consistencies. The flexibility of being able to hold meetings from time to time in New York or other U.S. locations is important from a shareholder relations point of view.

B. Recommendation

Permit meetings of shareholders to be held outside Canada (1) at one or more places[90] specified in the articles or (2) if all the shareholders entitled to vote at the meeting so agree.

Pros:

- The recommendation would enhance corporate flexibility.
- This change could decrease the cost of meetings for foreign-controlled corporations and Canadian globally-oriented corporations.
- Canadian corporations could have shareholders meetings in regions where they are trying to develop markets.
- Given that the vast majority of shareholders vote by proxy and do not actually attend shareholder meetings, the impact upon corporate governance in not expected to be large.
- Shareholders are protected by the requirement that the places must be specified in the articles of the corporation. Any changes to these locations would require approval of two-thirds of the shareholders (s. 173(1)(o)).

The Registrar rarely denies an application to hold a meeting outside the province. Nevertheless, applying to the Registrar for an exemption does involve some delay and expense.

Requiring meetings to be held in British Columbia ensures that most British Columbia residents are able to attend the meeting. On the other hand, the residence of a member, or the location of the company, or some other reason may suggest that the location of the annual meeting should more appropriately be outside the province.

[89] Model Business Corporation Act, section 7.01. The Delaware General Corporations Law is largely the same (ss. 211(a)).

[90] It may be more appropriate to refer to jurisdictions\countries. Requiring the articles to specify every city in, say, the United States where a meeting might be held appears burdensome.

Cons: ! This recommendation may prejudice smaller retail investors who can not afford to attend an annual meeting outside Canada.

C. Options

Option 1: Change the proposed requirement of unanimous consent of shareholders entitled to vote at the meeting to a requirement for consent of two-thirds of the shareholders entitled to vote at that meeting.

Option 2: Permit shareholder meetings to be held outside Canada if specified in the articles or through approval of two-thirds of the shareholders entitled to vote at that meeting.

Option 3: Status quo.

[112] The recommendations contained in the discussion paper are not in any sense government or even departmental policy. Rather, they are ideas that have come about largely through preliminary discussions with stakeholders across the country. This paper, and the consultations that will follow, are intended to solicit new ideas on how directors' and other corporate residency requirements can be improved. All suggestions are welcome.

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APPENDICES

APPENDIX A

ORIGIN OF DIRECTORS' RESIDENCY REQUIREMENTS

Early Canadian corporate laws

One legal article noted in 1979 that "nationalistic restrictions on foreign management and ownership are relatively new (20 years or less)".[91] However, the article also noted that:

> ... a similar majority Canadian resident director requirement did exist in general Canadian corporate law over 100 years ago but the requirement was repealed before the turn of the century[92].

Early general incorporation statutes[93] did include residency requirements. These laws required that a majority of the directors be persons resident in Canada and subjects of Her Majesty by birth or naturalization (see Canada Joint Stock Companies Letters Patent Act, 32-33 Vic. (1869), c. 13, s. 18).

The requirement in the federal law that the directors be subjects of Her Majesty was repealed in 1877 (An Act to amend the law respecting the incorporation of Joint Stock Companies by letters Patent, 40 Vic. (1877), c. 43, s. 28. In 1902, the requirement that the directors be resident in Canada was repealed by The Companies Act, 2 Ed. VII (1902), c. 15, s. 63.

However, requirements also found in early companies clauses laws[94] have not been repealed. The Canada Joint Stock Companies Clauses Act, 32-33 Vic. (1869), c. 12, s. 9 required that the major part of the directors be persons resident in Canada and subjects of Her Majesty by birth or naturalization. The wording has not changed since then; we currently find the same residency requirement in the Canada Corporations Act, Part IV, s. 167.

Post-War Concerns About Control

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[91] Brent Lisowski, "The New Canadian Director: Coping with the Requirement for a Majority of Resident Canadians on the Board of the Canadian Subsidiary," The Business Lawyer, vol. 34, April 1979, p. 1302.

[92] Ibid., p. 1302.

[93] That is, statutes providing for incorporation of the company under that law as opposed to incorporation by a special act of Parliament.

[94] These rules apply to companies incorporated by special acts of Parliament and are often utilities and transport companies. Emphasis on Canadian management (and indeed ownership) of these types of companies seems more relevant to the "national interest" than general rules applicable to all corporations. This is essentially the opinion expressed in the Dickerson Report set out below.

Over 50 years after the directors' residency requirement was removed from the federal business corporations legislation, the need for this requirement was again raised by the Royal Commission on Canada's Economic Prospects. The 1957 Report of the Royal Commission analyzed changes in foreign investment in Canada. It reported that:

> In the late nineteenth century, most of the foreign investment in this country came from the United Kingdom. Most of it was concentrated in the railways, in financing the requirements of governments at all levels and in the construction of basic utilities. Also, most of it was in the form of debt rather than in equities. ... In more recent years, however, the patterns have changed remarkably with the growth and spread of Canadian subsidiaries of American and other foreign companies. In the 1920's with the development of the newsprint and mining industries, foreign capital began to be invested in Canada in the form of equities rather than debt. It was during the 1920's moreover, that the most important form of investment began to be direct investment in Canadian industry mostly in Canadian subsidiary companies of foreign-owned concerns. ... These trends have become even more pronounced since the end of the last War ... .
>
> In the ten years since the War, the total amount of United States investment in Canada has more than doubled. The increase has been very largely in the form of direct investment and is represented in the main by equity holdings. ...[95]

The Royal Commission's Report noted:

> ... In the course of the Commission's hearings, concern was expressed over the extent to which our productive resources are controlled by non-residents, mostly Americans. Many Canadians are worried about such a large degree of economic decision-making being in the hands of non-residents or in the hands of Canadian companies controlled by non-residents. This concern has arisen because of the concentration of foreign ownership in certain industries, because of the fact that most of it is centred in one country, the United States, and because most of it is in the form of equities which, in the ordinary course of events, are never likely to be repatriated. ...
>
> At the root of Canadian concern about foreign investment is undoubtedly a basic, traditional sense of insecurity vis-à-vis our friendly, albeit our much larger and more powerful neighbour, the United States. There is concern that as the position of American capital in the dynamic resource and manufacturing sectors becomes even more dominant, our economy will inevitably become more and more integrated with that of the United States. Behind this is the fear of continuing integration might lead to economic

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[95] Government of Canada, <u>Report of the Royal Commission on Canada's Economic Prospects</u>, Final Report, November 1957, pp. 380-381.

> domination by the United States and eventually to the loss of our political independence. This fear of domination by the United States affects to some extent the political climate of life in Canada today.[96]

The Royal Commission recommended:

> In light of these various considerations, we believe the main objectives of Canadians in this matter should be: first, to see a larger share of foreign capital invested in the form of bonds and mortgages, which do not involve control of large sectors of the economy; secondly, to see that the part of foreign investment which is invested in the resource and manufacturing industries is associated in some degree with Canadian capital and Canadian interests; and, thirdly, to ensure that control of the Canadian banks and other financial institutions is retained in Canada. We shall propose more detailed objectives respecting the operations of foreign concerns which do business in Canada through the medium of Canadian subsidiary companies ... . Our purpose in doing so is to ensure that such concerns are aware of and susceptible to Canadian influences and opinions when they make decisions respecting their policies and activities in Canada. ...[97]

One of the recommendations was that foreign-owned concerns "should include on their boards of directors a number of independent Canadians ... . We have in mind something of the order of 20 per cent to 25 per cent".[98]

It appears that the Report of the Royal Commission was not received favourably by the governments of the day[99] and the recommendation concerning Canadian directors was not then adopted.

In 1968, the Report of the Task Force on the Structure of Canadian Industry (the "Watkins Report") was presented to the President of the Privy Council, Walter Gordon, who had been the Chairman of the Royal Commission on Canada's Economic Prospects. The Task Force was made up of eight prominent Canadian economists and economics professors and was headed by Melville H. Watkins.

Like the Royal Commission's Report, the Watkins Report referred to the increase in direct foreign investment and concerns over it. Under the heading "Policy Alternatives", the Watkins Report noted:

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[96] Ibid., pp. 389-90.

[97] Ibid., pp. 392-393.

[98] Ibid., p. 393.

[99] Walter L. Gordon, A Political Memoir, 1977, p. 68.

> ... there is a concern on the part of governments [in many countries] to maintain the political independence and sovereignty of their nation-state. There is a consensus that, beyond some upper limit, the foreigner becomes dominant and therefore dangerous, but there is little consensus on where that limit is. No other country, however, seems prepared to tolerate so high a degree of foreign ownership as exists in Canada.[100]

The Report also noted that there was no overall comprehensive policy on foreign investment:

> The substantial increase in foreign direct investment since 1950 has resulted in a number of specific policy steps. The Canadian tax structure has been altered in various ways to encourage foreign investors to do things deemed consistent with the Canadian interest. The balance of payments implications of foreign investment have received considerable attention. Incidents of American extraterritoriality and the issuing of American guidelines to direct investment firms have created much apprehension and some new policy initiatives, of which the most notable is Canadian guidelines for foreign-owned firms. No systematic overall policy has emerged, however, and Canadian policy remains one of the most liberal in the world.[101]

Under the heading of "Canadian Participation", the Watkins Report recommended generally:

> Foreign ownership and control are not only pervasive in Canada but are likely to remain so. There is a need to ensure Canadian participation in the benefits of foreign direct investment and a Canadian presence in the decision-making of multi-national enterprises.[102]

However, the Report does not appear to make any recommendations respecting Canadian directors. Instead, the remaining three recommendations under the heading of "Canadian Participation" focused on changes to the tax system, the creation of the Canada Development Corporation ("to assume a leadership role in Canada's business and financial communities") and "stronger incentives ... to encourage large corporations, including foreign-owned subsidiaries, to offer their shares to Canadians, thereby increasing the supply of Canadian equities, facilitating disclosure, and providing levers for public regulation and for dealing with extraterritoriality."[103]

The Report's recommendations were not adopted by the federal government at that time.

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[100] Government of Canada, Privy Council Office, Foreign Ownership and the Structure of Canadian Industry, Report of the Task Force on the Structure of Canadian Industry, January 1968, p. 363.

[101] Ibid., p. 384.

[102] Ibid., p. 411.

[103] Ibid., pp. 411-412.

In 1970, a non-partisan group of nationalist Canadians was formed, called the Committee for an Independent Canada. This group promoted Canadian economic nationalism, urging action to regain Canadian control of the economy.[104]

The Committee for an Independent Canada promoted Canadian economic nationalism through petitions, meetings with politicians and the publication of a number of articles and books.[105] In "Corporate Accountability: the Canadian Interest", an article published by the Committee in 1974, lawyer Michael Gough reviewed several options concerning the issue of Canadian directors:

> The role of the Canadian director charged with representing the Canadian interest might be accomplished in one of several ways: First, special interest directors might be elected by Canadian shareholders and be accountable to them as their representatives. Second, all corporations might be required to have a majority of Canadian directors on their board. Third, provision might be made for the election or appointment of a public interest director.[106]

He continued:

> The second possible alternative is to require by statute that every corporation have a majority of resident Canadians upon its board of directors. The unspoken assumption is that this majority of Canadian directors will likely lead to corporate policies beneficial to Canada. It is this course which Ontario has recently adopted and has reinforced by requiring that any executive committee of the board and the quorum for meetings of the board or that committee also contain a majority of Canadian directors. It now appears likely that Ottawa and British Columbia will enact similar proposals.
>
> To a great extent this legislation has the effect of recognizing, at least in Ontario, what is already largely fact: that a majority of directors on the boards of Canadian corporations 50 per cent or more non-resident owned, are already Canadian citizens resident in Canada. What is sought is to add more Canadian flavour to those corporations not yet meeting this standard. ...
>
> ... the better course might be to require that two-thirds of the board of directors be composed of resident Canadians. At least a majority of these directors should be neither employees nor professional advisors to the corporation. ...

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[104] Walter L. Gordon, A Political Memoir, pp. 315-316.

[105] For example, A. Rotstein and G. Lax, eds, Getting it Back (1974), and A. Rotstein and G. Lax, eds, Independence [:] the Canadian Challenge (1974).

[106] Rotstein and G. Lax, gen. ed., Getting it Back, (1974), Corporate Accountability: the Canadian Interest, by Michael Gough, p. 89.

> When coupled with the greater public disclosure recommended, Canadian directors would be able to query, for example, the amount of processing or fabrication of the corporation's exports, payments to be made to the foreign parent under licensing agreements and the capital outflow to head office for research and development which might otherwise be conducted in Canada.[107]

Another influential book of this period was Silent Surrender by Professor Kari Levitt of McGill University. This book warned of the "recolonization of Canada" and "lengthening dependence". Its introduction sets the tone for the book:

> This book presents a sketch of Canada's slide into a position of economic, political and cultural dependence on the United States. It seeks to explain the process whereby national entrepreneurship and political unity have been eroded to a point beyond which lies disintegration of the nation state.[108]

Enactment of the Canadian corporate law directors' residency requirements

By the early 1970s, the need for a Canadian directors' residency requirement appears to have received broad support. When corporate laws were changed to adopt directors residency requirements, the provisions were adopted without much opposition.

Ontario

Ontario was the first to proceed. In June 1972, Ontario tabled legislation to require that companies incorporated under the Ontario Business Corporations Act have a majority of Canadian residents on the board of directors. The Toronto Star reported:

> By Oct. 1, 1972, more than half of the directors of each company incorporated in Ontario will have to be Canadian living in Canada, Premier William Davis said yesterday.
>
> "This is in line with what I believe to be the essentials of a sound foreign investment policy," Davis told the Legislature in an hour-long speech devoted almost entirely to what he said was Ottawa's abdication of its responsibility in curbing foreign control.
>
> "Ontario realizes that it has an important role and responsibility to discharge not only through its own policies but in making constructive suggestions that may lead to federal

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[107] Ibid., pp. 90-92.

[108] Kari Levitt, Silent Surrender: the multinational corporation in Canada, 1970, p. xix.

> action," said Davis who has charged that takeover legislation currently before the federal parliament is too limited in scope and too weak.
>
> Davis announced "a new initiative in economic policy development for Ontario" and said his government "continues to be disheartened by the absence of a full federal commitment" for national programs on foreign ownership and other policies. ...
>
> Immediate reaction to the legislation was mixed. Opposition spokesmen said it did not go far enough. Businessmen pointed out that a board of directors, which is elected by the shareholders of a company, often has limited control of operations in a Canadian subsidiary where the only shareholder is a large foreign parent company. ...
>
> Setting a minimum membership requirement for boards of directors was one of the major recommendations of a select committee of the Legislature on economic and cultural nationalism whose first report was made public on March 1 this year.
>
> The committee, made up of 11 MPPs representing all three parties in the Legislature, urged Ontario to move immediately to control foreign investment without waiting for federal action. ...
>
> Davis said his government was committed to a policy of "positive economic and cultural nationalism in five fundamental elements that we feel should be included in a Canadian foreign investment policy." These were:
>
> - More prominent Canadian participation in new enterprises;
> - Canadian domination on the boards of directors of subsidiary firms in Canada;
> - Increased Canadian equity participation in all Canadian-based enterprises;
> - Foreign investment not intended to control policies of companies in which the investment is made;
> - Clear guidelines applying to the performance of foreign industry and unions in Canada.[109] [Emphasis added]

During Second Reading Debate on the legislation held on November 27, 1972, some opposition members questioned the efficacy of the provisions. One member said:

> Well, I suppose on the surface - and this was applauded by all of those deep-thinking newspaper editorial writers and political commentators - this was a great idea.

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[109] "Ontario will require majority of Canadians on company boards", Toronto Star, June 16, 1972, pp. 1 and 4.

> Except that the minister must realize - and this particular minister who is now carrying the Act must know full well - that this is a completely meaningless gesture; that there is no problem at all if Americans, or other aliens, want to keep control of Ontario companies. It is the easiest thing in the world to have the director nominally a Canadian, and the real control lies beyond the borders of Ontario, or beyond the borders of Canada.
>
> If the government was in fact serious, or if the government wanted to make this kind of provision meaningful, surely it would have followed down the trail.[110]

Another opposition member said:

> ... it is perhaps only a marginal improvement. I am not at all certain that a Business Corporations Act in fact can have the provisions which will reflect a determined policy of the government with respect to the control, elsewhere than in Canada, of the industrial economy of Canada. ...
>
> ... I think, therefore, that the only advantage, marginal as it is, helpful as it is, is that by having a majority of the directors of Ontario companies be Canadians, those directors can assert what might otherwise be overlooked - that is, the consideration of some aspects of the problems which have a peculiarly Canadian content to them.[111]

The Minister of Consumer and Commercial Relations, the Honourable J. T. Clement, who was the Minister responsible for the Bill, explained why the legislation was needed in terms of accountability of directors:

> ... my experience has been ... that you must have someone within the jurisdiction of this particular country that you can get to in the event that there has been any breach. If you have directors of Canadian corporations or Ontario corporations who are resident in the United States or other jurisdictions and they have committed infractions, perhaps even of the Criminal Code but they are not subject to extradition, there is no way we can bring them back to this bailiwick to have justice meted out to them in accordance with whatever legislation may require.[112]

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[110] Legislature of Ontario Debates, Mr. V. M. Singer, M.P.P., November 27, 1972, Official Report, p. 4848.

[111] Legislature of Ontario Debates, Mr. Renwick, M.P.P., November 27, 1972, Official Report, p. 4851.

[112] Legislature of Ontario Debates, the Honourable J. T. Clement, Minister of Consumer and Commercial Relations, November 27, 1972, Official Report, p.4855.

By the end of the year, Ontario had amended its legislation, not only to require a majority of resident Canadian directors, but also to impose majority requirements with respect to quorum, committees and location of directors' meetings.[113]

Federal government

In 1970, at the Federal level, a working group was established to prepare materials and examine certain factors which should be considered in the government's review of foreign investment policy.[114]

The working group published Foreign Direct Investment in Canada in 1972. The document, while published by the government, expressly noted that it was not a statement of government policy.[115]

This document addressed the issue of Canadian directors (at pp. 513-7) in the context of a number of proposals to improve Canadian control over foreign investment. Other proposals included mandatory Canadian shareholder control (not supported), government directors (should be studied further) and separate election of Canadian directors by Canadian minority shareholders (not supported).

With respect to "Mandatory Canadian directorships in all foreign controlled firms", the report indicated:

> ... a number of countries attach some importance to having their nationals elected to the boards of directors of foreign controlled firms in their jurisdiction.
>
> The feeling generally seems to be that this helps the foreign controlled firm to understand the economic, political and social environment of the host country and better to appreciate its cultural distinctions. It may also be intended to help integrate the foreign controlled firm into its host environment and to enable it to contribute more effectively to the local economy.

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[113] Parliament of Ontario, an Act to Amend the Business Corporations Act, S.O. 1972, c. 138, s. 32 adding s. 122(3), s. 33 amending s. 130(2) and adding s. 130(3) and (4), s. 34 amending s. 132(2) and s. 35(1) amending s. 133(1) of the Business Corporations Act.

[114] Foreign Direct Investment in Canada, published by the Government of Canada (1972), page v.

[115] Ibid., p. v.

> The question arises whether all foreign controlled firms ought to be required to elect a minimum proportion of Canadian citizens ordinarily resident in Canada to their boards of directors (say one-half). If a review process were established, legislation could be enacted directing the review agency to reject foreign investment proposals where the requirement for Canadian directors is not complied with. Other ways of achieving this objective might also exist, such as requiring by law that all foreign controlled firms incorporate federally, requiring as a condition of such incorporation that a designated proportion of the directors be Canadian citizens resident in Canada.
>
> An alternative to this possible policy element would be to provide that the review agency could take account of the willingness of foreign firms to have Canadian citizens serve as directors as a further factor to be weighed in considering proposed investments. Provision for Canadian directors would then not be a mandatory requirement, but simply one factor to be taken into account.
>
> The election of directors in itself is not a step of great significance. The Canadian director can simply be the figurehead for the parent company's management or he can be someone of independent strength and standing.
>
> The possibility of achieving stronger representation might be reinforced by a requirement that Canadian [sic] elected to the boards of foreign controlled firms come from outside the company.
>
> Although it is unlikely to be of major significance, mandatory provisions relating to Canadian directors could possibly contribute in some measure to an improvement in the performance of foreign controlled firms - particularly if this step were adopted in conjunction with other approaches that have been raised for consideration throughout this study[116].

This report was the basis of the amendments of the directors residency provisions in the CBCA.

The 1971 Dickerson report, which was in general the genesis of the enactment of the CBCA in 1975, had recommended against any directors' residency requirement:

> Canadian industry being what it is, it seems a futile gesture to impose a general requirement that directors of federally incorporated corporations should be citizens or residents of Canada. If, in a particular industry, it is thought desirable as a

[116] Ibid., p. 515-516.

> matter of government policy to insist upon such a qualification, this should be the subject of specific legislation.[117]

Both Bill C-213, introduced in Parliament in July 1973 and purposely allowed to die, and Bill C-29, introduced in October 1974, included provisions on directors' residency requiring that:

1. A majority of the directors of a CBCA corporation must be resident Canadians.[118]

2. Directors shall not transact business at a board meeting unless a majority of directors present are resident Canadians.[119]

3. A majority of members of each committee of the board must be resident Canadians.[120]

The directors' residency requirements originally proposed in Bill C-213 imposed an additional limitation on the boards of foreign controlled corporations requiring them to have a majority of outside directors. Officers and other senior employees of a Canadian subsidiary would not be counted in determining whether there was a Canadian majority. Due to "an extraordinary number of heated, even passionate criticisms", the government removed this additional limitation when it introduced Bill C-29.[121]

The "Detailed background papers for the Canada Business Corporations Bill" which was the main briefing paper for Bill C-29 gave the following policy analysis:

> In this Part, there is also the proposal requiring that a majority of the directors of a corporation be resident Canadians. Some of the major initiatives of the government in this area in recent years have been the introduction of the Foreign Investment Review Act and the revision of the acts regulating financial intermediaries and some resource corporations

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[117] Robert W.V. Dickerson, John L. Howard, Leon Getz, <u>Proposals for a New Business Corporations Law for Canada</u>, 2 vols, (Ottawa: Information Canada, 1971), par. 201, 1:72.

[118] <u>Canada Business Corporations Act</u>, (CBCA), R.S.C., 1985, c.C-44, Subsection 105(3). Subsection 105(4) creates an exception for holding corporations which earn less than five percent of gross revenues in Canada -- in such cases, not more than one third of the directors need be resident Canadians.

[119] Subsection 114(3) of the CBCA.

[120] Subsection 115(2) of the CBCA. Subsection 115(1) also requires that, where the powers of the board have been delegated to a committee of directors or a managing director, a majority of the committee members or the managing director must be a resident Canadians.

[121] House of Commons, Honorable Otto Lang, Minister of Consumer and Corporate Affairs, Second reading speech, Hansard, November 8, 1974, pp. 1202-1203.

> to restrict foreign ownership and control. Nevertheless, it was decided that the corporation law could usefully buttress these provisions by ensuring that the Canadian viewpoint would be expressed in all meetings of directors and committees of directors of corporations controlled by persons who are not resident Canadians. To achieve this goal the Bill requires that:
>
> - A majority of the directors of a corporation must be "resident Canadians", defined to include both Canadian citizens and landed immigrants who have resided in Canada less than six years.
> - Where a holding corporation earns less than 5% of its consolidated revenue in Canada, only one third of its directors are required to be resident Canadians.
> - The rules that apply to the board of directors also apply to a quorum of the board and to any committee of directors, except in respect of a holding corporation earning less than 5% of its revenue in Canada.
>
> The Bill does not set out any specific rules relating to foreign controlled corporations, therefore employee-directors of a corporation may be included to determine whether a corporation has a majority of resident Canadian directors.[122] [Emphasis added]

The purpose of the Foreign Investment Review Act was to review and approve or disallow business investment in Canada.[123] "It grew out of sentiment favouring Canadian economic nationalism and reflected the philosophy that no such foreign investment should be permitted unless it could be shown that it would result in a significant benefit to Canada."[124]

Directors' residency requirements were raised in both the House of Commons and the Senate Bill C-29 Second Reading speeches and in committee debates in both Houses. All of the speeches emphasize the relationship of these provisions to other initiatives of the government to restrict foreign ownership and control.

The Honourable Otto Lang, Minister of Consumer and Corporate Affairs, stated in the Bill C-29 second reading speech:

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[122] Detailed background papers for the Canada Business Corporations Bill, (1975), p. 12.

[123] Doing Business in Canada, Release no. 15, April 1993, p. 1-17.

[124] Ibid.

> Some of the major initiatives of the government in this area in recent years have been the introduction of the foreign investment review bill and the revision of the acts regulating financial intermediaries and some resource corporations in order to restrict ownership and control. It was decided that the corporation law could usefully reinforce these policies by ensuring that the Canadian viewpoint will be expressed in all meetings of directors and committees of directors.[125] [Emphasis added]

The Opposition supported this amendment.[126]

The only other debate in the House of Commons on this point was a question raised in the Justice and Legal Affairs Committee on whether the limitation on directors would deny corporations foreign know-how and experience that would normally be available to corporations through directors from other companies. The government responded that foreign directors can sit as directors provided that they are not in a majority and that foreign expertise can be available through means other than directors.[127]

Alberta

In 1975, Alberta also adopted a directors' residency requirement (requiring a majority of directors of Alberta corporations to be residents of Alberta). During Second Reading of Bill 61, The Companies Amendment Act, 1975, Premier Loughheed argued:

> What we're saying in Bill 61 is that there's no question that in an ownership/shareholder basis, investment is welcome from other parts of Canada, and for that matter from other parts of the world, to come into Alberta and to incorporate a company here. ...
>
> The basic aspect behind Bill 61, in our view, is that we are assessing Alberta's industrial strategy, that it's important to this province how we develop as a province. It is important that there be a corporate responsibility and awareness of the nature of Alberta's development over the course of the next decade, because we want that development to occur, in the interests of Albertans, in somewhat different directions than it has occurred in the past.

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[125] House of Commons, The Honourable Otto Lang, Minister of Consumer and Corporate Affairs, Hansard, November 8, 1974, p. 1202.

[126] House of Commons, The Honourable Sinclair Stevens, M.P., Hansard, November 8, 1974, p. 1205.

[127] House of Commons Hansard, November 21, 1974, p. 4:21.

> ... as we said on our European mission, and as we've said in other parts of Canada, we want you to come here with your dollars not to buy raw land and sit on it and hedge against inflation, not to come and to use your moneys here with just your own operation, but to come and be a partner with Alberta business as it exists today, to be a joint venture partner. That means participating in partnership with Albertans who are living here, who have their roots here, and are committed here.
>
> I think a bill such as this is a message, because it's not a majority, it's not 100 per cent, it's one-half. It's a message to the business community of what we look for ... . [S]urely they have a corporate responsibility to assure that at least one-half of the people who are making the corporate decisions for them live here and are affected by our environmental, education, social, business, tax, and other considerations. [I] feel that's extremely important at this stage in our development.[128]

By the end of the decade, all provinces except the three Maritime Provinces and Quebec had adopted a directors' residency requirement.

Recent developments

While a great deal has been said about FIRA and its replacement, the Investment Canada Act, little discussion has occurred on the issue of CBCA directors' residency requirement since its adoption. One exception is the Macdonald Commission Report which recommended the following in 1985:

> The Canada Business Corporations Act requires that a majority of directors of a Canadian corporation be "resident Canadians", and most provincial company acts incorporate a similar requirement. These federal and provincial company laws do not, however, impose any particular duties or requirements on Canadian directors to ensure that a Canadian, as compared to a foreign, viewpoint affects corporate decision making. Yet surely, Canadian directors should seek to reflect in corporate decisions their beliefs concerning the ambitions and interests of our national community. Commissioners believe that it would be desirable to amend existing company laws to make clear provision obliging Canadian directors to ensure that Canadian interests receive serious and sustained consideration in the making of all important corporate decisions. Legislation should require Canadian directors to file an annual report, which would accompany the informational return just described, setting out their corporation's efforts to promote the performance objectives

[128] Alberta Hansard, November 20, 1975, p. 1224.

identified in the proposed general code of conduct.[129] Such a reporting obligation would permit public scrutiny of the extent to which directors have discharged their responsibility to reflect Canadian interests.[130]

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[129] The code of conduct proposed by the Macdonald Commission would include items such as R&D expenditures, purchases from affiliated firms, and exports to affiliates and unrelated buyers (p. 242).

[130] Report of the Royal Commission on the Economic Union and Development Prospects for Canada, 3 vols., 1985, 2:242.

APPENDIX B

STUDIES ON DECISION-MAKING BY BOARDS OF DIRECTORS

It has been almost 20 years since the implementation of the directors' residency requirements in the Canada Business Corporations Act. However, no studies have been undertaken to verify the efficiency and effectiveness of the requirements. Research by Industry Canada did not uncover any studies on the specific topic of the improvement of decision-making on boards when a majority of directors are resident Canadian. The lack of empirical evidences regarding the improvement of decision-making on board is probably due to the fact that no monitoring on this issue was done since the adoption of the provision. As reported by the Macdonald Commission Report, "federal and provincial company laws do not, however, impose any particular duties or requirements on Canadian directors to ensure that a Canadian, as compared to a foreign, viewpoint affects corporate decision-making".

One American author, Mark P. Kriger has written some articles on the role of subsidiary boards. In one of his articles, Mark Kriger specified that since multinationals corporations (MNC) "increasingly rationalize their international systems and weigh comparative economics, they are beginning to close down manufacturing facilities and shifting production to more efficient subsidiaries. These decisions can have devastating effects on subsidiaries. The presence of a strong subsidiary board able to discuss these policy decisions with the parent company can help to create alternatives which are more sensitive to host country needs. The board can strike a workable compromise between the short-term optimal economic solution from the parent company's viewpoint, and the long-term acceptance of the subsidiary in the host country."[131]

This kind of "proactive use of subsidiary boards is a mechanism for both coping with local legal and political pressures and for increasing the access to information about local economic development." By more extensively utilizing this information, some MNC's have begun to develop active subsidiary boards as a means for strategic governance in multinational arenas. Host governments may then come to perceive the MNC as less hostile to the local country. "Much depends upon the internal processes of these boards and their on-going relationship with local governments. If managed properly, the relationship between subsidiary and host government can become a plus for both sides."[132]

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[131] Mark P. Kriger, Strategic Governance: Why and How MNCs are using Boards of Directors in Foreign Subsidiaries, Columbia Journal of World Business, Winter 1987, p.44.

[132] Mark P. Kriger, The Increasing Role of Subsidiary Boards in MNC's: An Empirical Study, Strategic Management Journal, Vol. 9, 1988, p. 356.

To increase the proactive use of the subsidiary board, Mark P. Kriger recommends to parent company executives that both inside and outside directors should be named to the board and that the directors' profile of strengths should match the subsidiary's present and foreseeable needs.[133]

Kriger also recommends that the board should have enough decision-making power to make its views known.[134] It is important that the directors be able to influence the parent company on important decisions that concern the subsidiary.

Kriger also specifies that there is a "philosophical commitment that the subsidiary board of directors of a foreign MNC should include key locally prominent people to help create windows of understanding between host countries and foreign subsidiaries."[135] "Active subsidiary boards can help avert and prevent local corporate debacles and disasters as well as create added corporate vision in the complex structures we have come to know as multinational corporations."[136] However, Kriger does not recommend a specified number or portion of local directors.

In the same way of creating windows of understanding, a recent article in The Economist[137] suggests that "globalisation" is encouraging major multi-national corporations to diversify their board of directors and top management as well as those of their subsidiaries. The president of Matsushita, a Japanese electronics giant, said that to become a truly global company his company would have to diversify its top management. In the same way, Sony aims to give the top job in each of its subsidiaries to a manager from the host country. Sony has also appointed three foreigners to its board of directors.

Another example given is ABB, a firm with a board of eight directors from four different nationalities and an executive committee of eight people from five countries. Multinational corporations appear to be more concerned with a global representation on their own board and on the board of their subsidiaries.

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[133] Ibid, p. 356.

[134] Ibid, p. 357.

[135] Idem, Strategic Governance, p. 45.

[136] Ibid, p. 45.

[137] The Economist, July 30th, 1994, p. 57.

APPENDIX C

NAFTA

Article 1107 of NAFTA deals specifically with the issue of directors' residency requirements. This article is entitled "Senior Management and Boards of Directors". It comes under Chapter 11 "Investment" of Part V "Investment, Services and Related Matters". Article 1107 reads:

> (1) No Party may require that an enterprise of that Party that is an investment of an investor of another Party appoint to senior management positions individuals of any particular nationality.
>
> (2) A Party <u>may require that a majority of the board of directors, or any committee thereof</u>, of an enterprise of that Party that is an investment of an investor of another Party, <u>be of a particular nationality, or resident in the territory of the Party</u>, <u>provided that the requirement does not materially impair the ability of the investor to exercise control over its investment</u>. [Emphasis added]

CBCA requirements on board and committee composition seem to be covered by clause 2. The third CBCA requirement, a quorum of Canadian directors in order for the board to conduct business, does not appear to be prohibited by Article 1107.

Article 1108 allows Parties to list in Annexes various reservations and exceptions to requirements imposed by NAFTA. Clause 1108(1) provides that article 1107 (and other articles) do not apply to any existing non-conforming measure as set out in Annex 1. This Annex specifies the CBCA directors' residency provisions. There is no commitment to phase out these requirements.

United States negotiators argued that no reservations or exceptions were required in respect of the CBCA and similar directors' residency requirements because these provisions were expressly permitted by clause 1107(2). However, in order to ensure that American investors would not be able to argue that the CBCA residency provisions materially impaired their investment (and contravened NAFTA), specific reservations were made.

Whether clause 1107(2) protects the CBCA directors' residency requirements or they are saved by the reservation in clause 1108 and Annex I, these provisions do not infringe at least the letter of NAFTA or GATS.

With respect to the spirit of the agreement, the stated objectives of NAFTA in the "Investment" area are to:

1) significantly remove barriers to investment;
2) ensure non-discriminatory protection of NAFTA investors and their investment, and;
3) permit investors access to international arbitration to settle investment disputes.[138]

Also, it is stated that, with limited exceptions, each country will treat NAFTA investors no less favourably than it treats its own investors (national treatment) or than it treats investors of other countries (most-favoured-nation-treatment).[139]

The bottom line is that while the residency requirements do appear to comply with the express requirements of NAFTA, it can be argued that they do not comply with its spirit.

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[138] The North American Free Trade Agreement, An Economic Assessment from a Canadian perspective, Department of Finance, Nov. 1992, p.44.

[139] Ibid., p.44.

APPENDIX D

EXTRATERRITORIAL APPLICATION OF FOREIGN LAWS

Introduction

The extraterritorial application of foreign laws (extraterritorialities) and the legal rules on directors' residency are interrelated issues.

Extraterritorial applications of foreign laws are the result of states asserting jurisdiction over activities that occur outside their territory but affect their economy or other interests.[140] There are many kinds of extraterritorial applications of foreign laws. Certain specific cases occurring in the 1970s raised concerns among Canadians and were factors in the adoption of the directors' residency requirements.

The issue of extraterritorial application of foreign laws of laws is extremely broad. It's full impact on the issue of the CBCA directors' residency provision would be difficult to assess without a major and exhaustive study. This appendix provides an overview of the issue and examines one of the most acrimonious areas of dispute (U.S. export controls on trade with Cuba) and the Canadian response.

Overview of Extraterritorial application of foreign laws

Extraterritoriality in the 1990s, Working Paper Number 15 prepared for Investment Canada, provides a useful overview of the extraterritorial application of foreign laws. Relevant aspects of this paper and other secondary materials are set out below.

The following points from Extraterritoriality in the 1990s appear relevant:

- There are a number of areas of extraterritorial conflict where the laws, regulations or actions of another state may impinge on those of Canada.

- These areas include: antitrust law; judicial orders compelling the production and discovery of documents for litigation; securities regulation; laws with foreign policy objectives (e.g., export controls and asset freezes); and private transnational litigation.

- With the continued globalization, the extent of extraterritorial application of laws will increase. This may be good if proper regulation of international commerce

[140] Investment Canada, Extraterritoriality in the 1990's, Working Paper Number 15, 1993, p. i.

requires it. However, in the absence of a proper legal framework to protect the less mighty States, this may not be a positive development.

- Because of convergence of anti-trust and securities laws in the OECD countries, the ambit for conflict in most areas of extraterritorial application of laws is reduced.[141] However, the significance of the reduction is open to debate.[142] The prime area for conflict is with foreign policy objectives, enforced through export controls and assets freezes, particularly those of the United States.

- American extraterritorial actions are by far the most prevalent but the European Community also purports to exercise some extraterritorial jurisdiction, particularly in the field of anti-trust.

The European Community "economic entity" doctrine

A number of basis for jurisdiction over foreign-incorporated and operating companies is claimed. The European Community has used an "economic entity" doctrine to claim jurisdiction, primarily in the competition law field, over the foreign parent corporations of subsidiaries operating in the E.C. The paper Extraterritoriality in the 1990s refers to this type of claim for jurisdiction as the "unity theory". Another author uses still other terms: "The application of the territoriality principle may also take the form of jurisdiction based on the "economic unit", "enterprise entity" or "reciprocating partnership" theory."[143]

> ... the [European Court of Justice] upheld jurisdiction on the basis of the control exercised by the parents over their subsidiaries: the acts of the subsidiaries were to be treated as the

[141] The paper Extraterritoriality in the 1990s details various methods governments have adopted to minimize the conflicts (pp. 16-19), including work in the OECD and through bilateral treaties. For instance, after years of negotiations (starting in 1959), the United States and Canada signed a Memorandum of Understanding as to Notification, Consultation and Cooperation with Respect to the Application of National Antitrust Laws (March 9, 1984) 23 I.L.M. 275, described in J.-G. Castel, Extraterritoriality in International Trade (1988) pp. 90-1. In the securities law (and several other) areas, the United States and Canada have signed a Treaty on Mutual Legal Assistance in Criminal Matters (March 18, 1985) described in C. Greene, "International Securities Law Enforcement: Recent Advances in Assistance and Cooperation" (1994) 27 Vanderbilt Journal of Transnational Law 635, at 646-9.

[142] The case of Hartford Fire Ins. Co. v. California, is a prime illustration of a major difference which, following the decision of the United States Supreme Court, remains unresolved
[(125 L Ed 2d 612) U.S. Supreme Court, 28 June, 1993]. Canada, as a third party, felt compelled to appear in front of the Court to provide judicial information (a third party is obliged to appear, even if it had no interest in the cause of action).

[143] Castel, p. 16.

> acts of the foreign parent and so there was imputed to the foreign parents activity within the Community.
>
> ... the European Court of Justice ... has accepted an "economic entity" doctrine of jurisdiction over a non-EC parent based on the acts of subsidiaries with the Community.[144]

Very little material is readily available on the European Community law and the "economic entity" doctrine.

During consultations last year, one lawyer noted that some European clients did not to object to the majority residency requirement because a board composed of a majority of foreigners was a key element used in determining the independence of a subsidiary. Apparently, this independence is important for certain taxation rules. We understand that in some cases a parent would not have to pay taxes on the profits of an independent subsidiary. Whether this is relevant to other aspects of extraterritorial application of foreign laws is not clear.

U.S. Export Controls

The Americans have claimed jurisdiction over subsidiaries of American parents. Usually, the test is based simply on ownership and control, but the decision-making process has also been occasionally relevant.[145] The paper Extraterritoriality in the 1990s comments on the enforcement of laws concerned with foreign policy objectives, particularly export controls and asset freezes:

> There have been many disputes over export controls imposed in pursuit of foreign policy objectives. Once again, the main proponent of such controls has been the United States. It has asserted jurisdiction over foreign transactions based either on (i) a corporate link between the U.S. parent corporation and its foreign subsidiary (the unity theory of corporate ownership) or, less frequently, on (ii) its contention that goods and technical information exported from the United States continue to be subject to its jurisdiction. Extraterritorial ramifications have arisen from the application of U.S. economic sanctions upon, for example, China and North Korea, Cuba, and Iran. In response to the Arab boycott of Israel, the United States enacted anti-boycott provisions that had limited extraterritorial implications for foreign subsidiaries of American corporations involved in U.S. commerce.
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> Perhaps the most notorious assertion of extraterritorial jurisdiction occurred in the Siberian pipeline dispute. In June 1982, in response to Soviet involvement in political

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[144] Roth, "Reasonable Extraterritoriality: Correcting the 'Balance of Interests'", (1992) 41 International and Comparative L. Q. 245, at 161-2.

[145] See discussion below of U.S. rules concerning trade with Cuba.

repression in Poland, the United States imposed sanctions on the export and re-export of goods and technical data relating to oil and gas exploration, transmission and refinement.[146]

Trade with Cuba

American laws and regulations dealing with the extraterritorial application of foreign laws are vast and complex. Our research therefore has focused on the most acrimonious area of dispute between Canada and the U.S. -- U.S. rules with respect to trade with Cuba.

The history of U.S. extraterritorial rules on trade with Cuba began in the 1960s. The paper Extraterritoriality in the 1990s notes (p. 10) that the 1963 Cuban Assets Control Regulations,[147] passed under the U.S. Trading with the Enemy Act, prohibited the subsidiaries of U.S. corporations from trading with Cuba. But there were several exemptions. It appears that foreign subsidiaries could not trade with Cuba if the purchase involved U.S. dollar accounts or merchandise of U.S. origin.

These regulations were likely relevant in the MLW Worthington and Cole Division of Litton Business Equipment Ltd. Ltd. cases which arose at the time of the debate concerning the adoption of the directors' residency rules in the CBCA. In the spring of 1974, it appeared that the U.S. Government was about to block a $15 million sale of 30 locomotives to Cuba by MLW Worthington Ltd. of Montreal, a subsidiary of Studebaker-Worthington of Harrison, N.J.[148] In this case, the United States was apparently about to veto the locomotive sale because this would have been an infringement of the U.S. Trading with the Enemy Act.

The board of directors of MLW Worthington Ltd. held a vote on whether to continue negotiations with the Cubans. The nine Canadian directors voted yes. The one U.S. director present voted no and a second U.S. director, who was sick, sent word that he would vote no if present. It was suggested that the negative vote of the U.S. directors cleared them of violating the U.S. law.

In another case which was much more publicized by the news media in December 1974, a Canadian subsidiary manufacturing company, Cole Division of Litton Business Equipment Ltd., was unable to carry out an order for the sale of furniture to Cuba because of the U.S. Trading with the Enemy Act. At the time, the directors of the Canadian subsidiary of Litton were U.S.

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[146] Extraterritoriality in the 1990s, pages 9-11.

[147] 31 C.F.R. 515.541.

[148] "Ottawa to fight ban on Canadian sale to Cuba", The Globe and Mail, December 24, 1974, pages 1-2.

citizens and residents. Apparently, Washington did not block the deal but, since the parent company, Litton Business Equipment Ltd., heavily depended on U.S. defense contracts, they chose to interpret the law literally rather than risk trouble with Washington.[149]

Enactment of the CBCA directors' residency requirements and amendment of Canada's competition laws

Both cases were referred to when the CBCA was being considered for adoption. One newspaper article indicated that the CBCA directors' residency provisions were proposed because of the Worthington case. The article also suggested that these residency rules would block the application of foreign laws in the Litton-type situation.[150]

During the same period, in addition to the adoption of the residency requirement in the CBCA, Canada's Combines Investigation Act,[151] now called the Competition Act,[152] was amended to obstruct, among other things, these extraterritorial applications of foreign laws. With these new provisions, the Competition Tribunal can direct persons in Canada not to take measures to implement a foreign law, directive or judgment of a foreign court where such implementation would adversely affect the foreign trade of Canada without compensating advantages.[153]

However, since the adoption of these provision, twenty years ago, the Competition Tribunal has never issued an order under them. We understand however that the provisions have helped in negotiations and in at least one case the Tribunal was ready to issue an order. It is difficult to verify if the competition law provisions have been effective in dealing with extraterritorial application of foreign laws.

1975 and 1977 changes to the U.S. rules on trade with Cuba

Probably as a result of pressure from foreign governments (including Canada), the 1963 Cuban Assets Control Regulations prohibiting trade with Cuba were amended in 1975 to permit the:

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[149] Time, The Weekly Magazine, Vol. 105, no. 1, p. 35, January 6, 1975.

[150] "Ottawa to fight ban on Canadian sale to Cuba", The Globe and Mail, December 24, 1974, page 2.

[151] R.S.C. 1970, c. C-23.

[152] Competition Act, R.S.C. 1985, c. C-34.

[153] An Act to amend the Combines Investigation Act, S.C. 1974-75-76, c. 76, s. 12, adding ss. 31.5 and 31.6. These provisions are now ss. 82 and 83 of the Competition Act, R.S.C. 1985, c. C-34.

> ... foreign subsidiaries to trade with Cuba if the host state did not prohibit such trade. However, further amendments in 1977 banned any persons within the United States from participating in licensed Cuban transactions. Licences were only issued if the subsidiary was independent from its American parent in the decision making, risk taking, financing and conducting of the trade for which the licence was required and if it generally operated independently[154][Emphasis added].

Under these 1977 rules,[155] trade between U.S.-owned and -controlled firms and Cuba was permitted "where local law requires, or policy in the third country favours, trade with Cuba". There were several conditions, however, one of which was that "the affiliate must be generally independent, in the conduct of transactions of the type for which the license is being sought, in such matters as decision-making, risk-taking, negotiation, financing or arranging of financing, and performance".[156] The residency of the directors of the subsidiary board may have impacted on the issue of whether the subsidiary was "generally independent" and had independent "decision-making". Therefore, board membership and the requirement for a majority Canadian board may well have influenced whether this U.S. law applied to a Canadian subsidiary of a U.S. corporation.

A 1992 article in The Globe and Mail explained how trade with Cuba by U.S. companies through their subsidiaries was expanding:

> Even U.S. firms have sharply increased grain and wheat exports to Cuba, using foreign subsidiaries to dodge the embargo.
>
> U.S. companies sold $56-million in food to Cuba in 1988. The figure doubled in 1989 and jumped to $500-million last year [1991].[157]

1992 changes to the U.S. rules on trade with Cuba

Extraterritoriality in the 1990s refers to an attempt in 1990 to expand the prohibition:

> ... the proposed "Mack Amendment" to the U.S. Export Administration Act would have made it illegal for any U.S. subsidiary, including those in Canada, to do business with Cuba. The Canadian government announced that it was issuing an order under the

[154] Extraterritoriality in the 1990's, p. 10. See further discussion of the question of independence of decision-making below.

[155] 31 C.F.R. 515.559(b).

[156] S. 515.559(d).

[157] "Cuba casts about for economic pals", The Globe and Mail March 23, 1992, p. B4.

> Foreign Extraterritorial Measures Act to prohibit any Canadian-based company from complying with the U.S. law. In the end, the amendment was vetoed by President Bush... .[158]

However, two years later, the legislation was again brought forward and adopted.

The Cuban Democracy Act of 1992 was passed on October 23, 1992.[159] Section 1702 sets out the findings of Congress including s. 1702(8):

> The United States cooperated with its European and other allies to assist in the difficult transition from Communist regimes in Eastern Europe. Therefore, it is appropriate for those allies to cooperate with the United States policy to promote a peaceful transition in Cuba.

Section 1703 provides:

> It should be the policy of the United States --
>
> (1) to seek a peaceful transition to democracy and a resumption of economic growth in Cuba through the careful application of sanctions directed at the Castro government and support for the Cuban people;
> (2) to seek the cooperation of other democratic countries in this policy;
> (3) to make clear to other countries that, in determining its relations with them, the United States will take into account their willingness to cooperate in such a policy ... .

Section 1704 "International Cooperation" provides:

> (a) CUBAN TRADING PARTNERS.-- The President should encourage the governments of countries that conduct trade with Cuba to restrict their trade and credit relations with Cuba in a manner consistent with the purposes of this title.

Subsection 1704(b) imposes sanctions against countries which provide assistance, in the form of grants, concessions, guarantees or insurance, to the government of Cuba. The sanctions remove the eligibility of such country to U.S. foreign aid or debt reduction.

Section 1706 essentially repeals the 1975 and 1977 regulations permitting U.S. subsidiaries to trade with Cuba. This more restrictive regulation prohibits any "U.S.-owned or controlled firms"

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[158] Extraterritoriality in the 1990s, page 9.

[159] Title XVII of the National Defense Authorization Act for the Fiscal Year 1993, Public Law 102-484, ss. 1701-1712.

and any officer, director or agent of the subsidiary from trading with Cuba.[160] The term "U.S.-owned or controlled firms" does not appear to be defined but focuses on ownership and not how the board is structured.

Penalties relating to a breach of the prohibition on trade with Cuba are severe. Section 1710 of the Cuban Democracy Act of 1992 applies section 16 of the Trading with the Enemy Act, 50 U.S.C. App. 16. Section 16 provides:

> Whoever shall wilfully violate any provision of that act or any license, rule, or regulation issued thereunder ... shall, upon conviction, be fined not more than $1,000,000 or, if a natural person, be fined not more than $100,000 or imprisoned for not more than 10 years or both; and the officer, director, or agent of any corporation who knowingly participates in such violation shall, upon conviction, be fined not more than $100,000 or imprisoned for not more than 10 years or both.

Strenuous objections to the Cuban Democracy Act of 1992 were made by the governments of Canada, Cuba, the United Kingdom, the European Community and the United Nations and others.[161]

Foreign Extraterritorial Measures Act

In 1984, Parliament enacted the Canadian Foreign Extraterritorial Measures Act[162] ("FEMA"). A legal article by William C. Graham carefully reviews this legislation and its history:

> ... this law was originally introduced by the previous government in 1980 in substantially the same form ... but died on the order paper in November of 1983. ... It is a remarkable piece of legislation, the culmination point of an often-expressed frustration which Canadians have experienced through the extraterritorial application of American laws in Canada. This phenomenon has not, of course been restricted to Canadian-American relations and the law reflects concerns and contains provisions which may be found in

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160 31 C.F.R. 515.559(a).

161 See for example, "Cuba glitters in investors' eyes", The Globe and Mail, August 2, 1993, p. B4; "Britain defies ban on trade with Cuba", The Globe and Mail, October 23, 1992, p. B2; "UN resolution seeks repeal of U.S. embargo against Cuba", The Globe and Mail, November 25, 1992, p. A12; "U.S. opposes Canada's phone service to Cuba", The Globe and Mail, July 9, 1993, p. B8; "U.S. telephone companies complying with order to cut off relay calls to Cuba", The Financial Post, July 14, 1993.

162 R.S.C. 1985, c. F-29.

> similar legislation in various other jurisdictions which have also adopted measures, some defensive and some aggressive in nature, which respond to this same problem.[163]

The article reviews the historical context of the enactment of FEMA:

> For it must be recognized that, while not specifically so indicating, this legislation is primarily directed towards the United States, and represents the most aggressive form of defence to date adopted by Canada in the face of the problem of the extraterritorial application of American law to activities in this country.
>
> It may seem rather surprising, in the climate of the meeting between the Prime Minister and the President in March, 1985, at Quebec and the determination expressed to achieve a free trade arrangement with the United States, that the present government should have adopted such a forceful measure. Of course, the extent to which it may be applied remains to be seen; it may only be a way of letting the American administration know that there exists in Canada defensive, even retaliatory, measures necessary for the protection of Canadian economic sovereignty should the bounds of international propriety be overstepped in the assertion of American authority over matters which are considered primarily or even exclusively Canadian.[164]

Graham then briefly examines "historical antecedents [to the enactment of FEMA] that are both significant and numerous, involving cases where American laws have been applied to sanction activities carried on in Canada by Canadians, often in conformity with specific federal or provincial government policies."[165]

> ... laws relating to such diverse areas as restrictive business practices, export controls, securities (both in respect of corrupt practices and Arab boycott legislation), bankruptcy and insolvency, taxation (state unitary taxes), to name only some, have been applied to acts the primary locus of which has been in Canada.[166]

The article refers to the Canadian Radio Patents Limited case whereby the Canadian government attempted to promote the formulation of an indigenous Canadian television industry. The U.S. government prosecuted the parents of several Canadian subsidiaries for competition offences under the Sherman Antitrust Act.

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[163] Graham, "The Foreign Extraterritorial Measures Act", (1986) 11 Can. Bus. L.J. 410, at p. 410.

[164] Graham, pp. 412-3.

[165] Graham, p. 413.

[166] Graham, p. 413.

> ... as the Minister [of Justice at the time - 1959] pointed out in his speech [to the House of Commons], the American case resulted in requiring directors of Canadian companies to "take certain actions with respect to the operations of those companies in Canada, which actions would not be dictated by requirements of Canadian law, or being in accord with Canadian business or commercial policy, but would be dictated by requirements of the United States' policy." He went on to say that he deplored "the unacceptable proposition that foreign subsidiaries of U.S. parent companies are merely projections of U.S. trade and commerce and subject to U.S. policy in priority to the laws and commercial interests of countries in which such subsidiaries are incorporated and carry on business".[167]

Graham then refers to another case:

> More recently Canadian sensitivities were touched in the case of the Bank of Nova Scotia in Florida which arose when a court of that state required a branch of that bank to produce documents held by its separately incorporated affiliates, in the Bahamas and the Cayman Islands, in clear violation of the bank secrecy laws of these jurisdictions. The bank in the end produced the documents but it was required to pay a fine of over $1,800,000, a result confirmed by the Supreme Court of the United States ... .

The article gives several other examples and also quotes from the Minister's speech introducing FEMA into the House of Commons in 1984:

> So what does the Bill do? It sets out a framework for Canadian governmental responses to foreign governmental measures or decisions by foreign courts which have unacceptable extraterritorial scope. Yes, we want foreign investment. Yes, we want a better relationship, and we have a better relationship with the United States of America as an example. However, that does not mean to say that we are not going to defend our own vital national interests or our own Canadian sovereignty, and that is what the Bill does. The Bill gives us some muscle to do that. The Bill sets out the framework for us to respond to foreign government measures, or decisions by foreign courts, which we find to have unacceptable extraterritorial scope.[168]

FEMA provisions

FEMA covers three distinct areas of the extraterritorial application of foreign laws: "Disclosure of Records of Foreign Tribunals" (s. 3), "Measures of a foreign state or foreign tribunal" (s. 5)

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[167] Graham, p. 414.

[168] Graham, p. 415.

and "Recognition and Enforcement of Foreign Judgments [in proceedings instituted under an antitrust law]" (s. 8).

In each of the three cases, the Attorney General of Canada ("A.G.") can make an order protecting Canadian interests from foreign extraterritorial laws. Orders made under ss. 3 and 5 may be enforced through criminal proceedings (s. 7) where the maximum penalties for failing to comply with the order of the A.G. is $10,000 or 5 years in jail. Section 8 orders are backed up by civil liability in favour of Canadians who have been injured by the extraterritorial aspects of a foreign judgment.

- Sections 3 & 4 - "Production of Records"

Section 3 concerns the production of records before foreign tribunals (courts or other authorities). Where, in the opinion of the A.G., a foreign tribunal is exercising jurisdiction or powers in a manner that is likely to adversely affect "significant Canadian interest in relation to international trade or commerce involving a business carried on in whole or in part in Canada or that otherwise ... is likely to infringe Canadian sovereignty" the A.G. can, by order, prohibit the production of the records in that court case.

The A.G.'s order can relate to <u>any records "that are in Canada or are in the possession or under the control of a Canadian citizen or a person resident in Canada"</u>. The A.G.'s order can also prohibit the doing of any act in Canada that would result in the records being produced and in addition can prohibit the giving by a person, who is a Canadian citizen or a resident of Canada, information before a foreign tribunal in relation to the contents of the records, etc.

Section 4 authorizes the seizure of records at the request of the Attorney General.

The purpose of these provisions is presumably to deal with cases like the Bank of Nova Scotia in Florida case, described above, and the U.S. uranium antitrust litigation in the late 1970s and early 1980s:

> In the uranium antitrust litigation, for example, Westinghouse Electric Corporation commenced an antitrust action against U.S. and foreign uranium producers who, it alleged, had conspired to fix world prices and supply. The uranium "cartel" also figured prominently in litigation before other U.S. state and federal courts. Pre-trial demands were made for the discovery of documents situated outside the United States. The foreign governments considered the antitrust claim objectionable because they had established a "marketing arrangement" in response to a U.S. embargo on the importation of foreign uranium for use in U.S. nuclear reactors.

> The governments of Australia, Canada, the United Kingdom, and France employed existing legislation or enacted new legislation to authorize the issuance of non-disclosure orders to parties possessing documents situated in their territory.[169]

Sections 3 and 4 of FEMA are designed to empower the government to limit the impact of such foreign proceedings which are contrary to the national interest of Canada.

- Section 5 "Measures of Foreign State or Tribunal"

Section 5 concerns (1) the prime area of conflict -- foreign policy objectives, particularly those of the U.S.; and (2) the case where foreign tribunal merely assumes jurisdiction that is offensive. Under this section, the A.G. can, with the concurrence of the Minister for Foreign Affairs, by order, require "any person in Canada" to give notice to the A.G. of any specified extraterritorial measures and can prohibit "any person in Canada" from complying with such measures.

Again the order is predicated on the A.G. being satisfied that a foreign state or tribunal has taken measures affecting international trade or commerce of a kind that is likely to adversely affect "significant Canadian interest in relation to international trade or commerce involving a business carried on in whole or in part in Canada or that otherwise ... is likely to infringe Canadian sovereignty". The phrase "any person in Canada" could include a corporation doing business in Canada and its directors, officers and employees who are in Canada.

Graham notes that:

> This part of the legislation addresses a concern similar to that found in ss. 31.5 and 31.6 of the Combines Investigation Act which permits the Restrictive Trade Practices Commission to prohibit the implementation in Canada of foreign governmental orders or policies or foreign court orders which may adversely affect competition in Canada or otherwise affect the efficiency of a trade or industry in Canada or our foreign trade.[170]

Section 5, dealing it seems with the key area of conflict, is the only provision under which an order has been invoked. In all, just two orders have been issued, both relating to the same subject matter.[171]

- Section 8 "Proceedings instituted under an antitrust law"

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[169] Extraterritoriality in the 1990's, p. 6. Canadian courts refused to give affect to the orders of the U.S. courts on the grounds that it would be a wrongful exercise of discretion for the court to ignore government policy: Uranium Cartel Litigation: Gulf Oil Corp. v. Gulf Canada Ltd. [1980] 2 S.C.R. 39.

[170] Graham, p. 411.

[171] These two orders are discussed below.

Under s. 8, there must be a judgment of a foreign tribunal in proceedings under an antitrust law. The A.G. must be of the opinion that the recognition or enforcement of the judgment in Canada is likely to adversely affect "significant Canadian interest in relation to international trade or commerce involving a business carried on in whole or in part in Canada or that otherwise ... is likely to infringe Canadian sovereignty". The A.G. may by order declare that the judgment shall not be recognized or enforceable in any manner in Canada or reduce the amount of the award.[172]

Section 9 complements s. 8 by permitting a Canadian citizen or resident of Canada or corporation incorporated in Canada to sue for any amount collected by a person in contravention of the order made under s. 8.

- Offences under FEMA

Section 7 provides that the maximum penalty for any person who contravenes an order made under sections 3 or 5 is a fine not exceeding ten thousand dollars or imprisonment for a term not exceeding five years or both.

The $10,000 fine appears to be less of a threat than the $1,000,000\$100,000 fines under the U.S. Trading with the Enemy Act, or indeed the $1,800,000 fine imposed by the court in the Bank of Nova Scotia in Florida case, referred to above. However, the threat of five years in jail is likely a daunting penalty.

Orders issued under FEMA - Canadian response to U.S. rules on trade with Cuba

Two orders have been issued under FEMA, one in 1990 and the other in 1992, both in relation to trade with Cuba. The 1990 order was issued in anticipation that the so-called "Mack" amendment might become law. As noted above, this law was vetoed by President Bush and the 1990 FEMA order lapsed. A second order, with similar terms, was issued on October 9, 1992 in response to the Cuban Democracy Act of 1992. The order[173] recites that:

> ... in the opinion of the Attorney General of Canada, that measure [s. 1706 of the Cuban Democracy Act of 1992] is likely to adversely affect significant Canadian interests in relation to trade or commerce between Canada and Cuba involving business carried on in whole or in part in Canada or is otherwise likely to infringe Canadian sovereignty ... .

[172] The provision permitting reduction of the award is in response to the U.S. antitrust law triple damages provision which awards the party injured by anticompetitive actions triple their damages. Traditionally, civil law only permits the aggrieved party to recover an amount equivalent to the damage they suffer.

[173] SOR\92-584.

Section 3 of the Order requires:

> Every corporation and every officer of a corporation who receives, in respect of any trade or commerce between Canada and Cuba, any directives, instructions, intimations of policy or other communications relating to an extraterritorial measure of the United States from a person who is in a position to direct or influence the policies of the corporation in Canada shall give notice thereof to the Attorney General of Canada.

Section 4 provides:

> No corporation shall comply with an extraterritorial measure of the United States in respect of trade or commerce between Canada and Cuba or with any directives, instructions, intimations of policy or other communications relating thereto that are received from a person who is in a position to direct or influence the policies of the corporation in Canada.

The Regulatory Impact Analysis Statement attached to the order noted that:

> This extraterritorial application of United States law [the Cuban Democracy Act of 1992] would adversely affect approximately 30 million dollars of Canadian trade with Cuba annually, as well as restrict possible opportunities for trade growth. Such a displacement of Canadian law and policy by United States law and policy constitutes an infringement of Canadian sovereignty.
>
> ... It is expected that the Order will place some companies in a situation where they cannot comply with the United States law. This will, however, be due to the extraterritorial imposition of United States law to Canada in violation of Canadian sovereignty, and in violation of generally accepted principles of international law. Should any corporation be prosecuted in the United States for a violation of the [the Cuban Democracy Act of 1992], the existence of this Order can be considered by the American courts. The precise impact, however, will be for those courts to determine.
>
> The Order may also be expected to attract considerable political attention both in the United States and in Canada. The highest level of consideration of these potential impacts lies behind the concurrence given by the Secretary of State for External Affairs to the issuance of the Order. It is seen as a necessary measure to protect and safeguard Canadian sovereignty.

Just prior to the issuance of the 1992 order, an article, "Ottawa preparing to fight Washington's ban on trade with Cuba [:] Canadian subsidiaries could suffer 'unpleasant consequences' for complying with restrictions" in The Globe and Mail, reported:

> The federal government says it is ready to dust off an order making it illegal for firms in Canada to comply with a U.S. ban on trade with Cuba.
>
> The order is particularly geared toward Canadian subsidiaries of U.S. firms, which appear likely to be hit soon with a U.S. election-driven binge of anti-Cuba legislation.
>
> ... The U.S. move is considered an intrusion into Canadian sovereignty that is "clearly unacceptable" legally and politically, a spokesman for the Department of External Affairs said yesterday.
>
> "There could be potentially unpleasant consequences to this legislation," the spokesman, Denis Boulet, said. "We would block its application in Canada. The blocking order has been prepared before."
>
> The Canadian order, requiring firms to ignore foreign prohibitions on their trade with Cuba and to report any directives they receive concerning U.S. law, was issued in 1991 [sic] when Congress threatened a similar action against Cuba, known as the Connie Mack amendment.
>
> That amendment never came into effect, but in the closing days of this congressional session, some U.S. legislators pushed through a tougher new version that apparently enjoys greater favour in the White House.
>
> Canada, Britain and the European Community have all protested against the territorial application of laws. But, in the heat of the U.S. election campaign, no U.S. legislator has volunteered to stall passage of the ban.
>
> Canadian diplomats in Washington have said the U.S. ban and Canada's issuing of the non-compliance order in response could put executives and directors of U.S. subsidiaries at risk of being jailed in Canada if their trade with Cuba is halted.[174]

Under the Order,[175] only corporations and their officers are required to report directives and only corporations are required to not comply with the foreign directives.

Nine months later, a column in The Globe and Mail, "World View [:] Don't let Washington call the shots", criticized inaction under FEMA:

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[174] "Ottawa preparing to fight Washington's ban on trade with Cuba [:] Canadian subsidiaries could suffer 'unpleasant consequences' for complying with restrictions", The Globe and Mail, Sept. 25, 1992, p. A12.

[175] See discussion above.

> Who's in charge here? The Canadian Parliament? Or the U.S. Congress?
>
> Some Canadian subsidiaries of U.S.-based firms are turning away business deals with Cuba despite Canadian free-trade laws.
>
> The subsidiaries are following orders from U.S. head offices. Headoffice managers, in turn, follow Washington's order to comply with a Cold War-era trade embargo against Fidel Castro's pathetic Marxist regime.
>
> ... In one instance, Eli Canada Inc. rebuffed a request last February to export pharmaceuticals. Two months later, H.J. Heinz Co. of Canada Ltd., the Canadian subsidiary of the soup and ketchup company, said "no thanks" to a chance to sell food.
>
> Sources at both companies say their head offices called the shots. Nobody seems to have heard of the Canadian law that is supposed to keep Washington from forcing its embargo onto the backs of Canadian companies.
>
> The Cubans say they have drawn Ottawa's attention to the Lilly and Heinz cases. But the Canadian government, locked in negotiations to save the Canada-U.S.-Mexico trade agreement, seems to have other priorities.
>
> ... Since [the order came into effect] the Department of External Affairs has referred about 20 cases of alleged violations of [the FEMA] order to the Justice Department for investigation. Canadian officials will not comment on any specific case; but the fact is there has never been a single prosecution in Canada under the Foreign Extraterritorial Measures Act.
>
> If Justice Minister Campbell was serious when she issued the order last October, what will Prime Minister Campbell do now? Will the Canadian managers of the subsidiaries be firmly reminded that they are Canadians, working in Canada, and must comply with Canadian law.[176]

Enforcement of FEMA

A Senior Counsel in the Constitutional and International Law Section of the Department of Justice indicated that it is the policy of his Department to actively enforce FEMA. A number of investigations have been turned over to the R.C.M.P. but no prosecutions have resulted. A serious problem has been a lack of evidence.

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[176] "World View [:] Don't let Washington call the shots", Globe & Mail July 16, 1993, p. A21.

In terms of Canadian residents, the Senior Counsel believed that having "persons in Canada" would be important for enforcement purposes. "Persons in Canada" is the wording used in FEMA and presumably means to someone actually present in Canada.

Analysis - Implications for CBCA residency requirements

While extraterritorial application of a foreign law may only depend on directors' residency in a few rare instances, directors' residency is relevant, at least in theory, to enforcement of the foreign laws and of FEMA.

In some instances, application of a foreign law may depend upon directors' residency (pre-1992 trade with Cuba and perhaps the European "economic entity" theory). In general, however, jurisdiction is claimed on basis of ownership and control of subsidiaries and not the management. Since the enactment of the Cuban Democracy Act of 1992, the application of U.S. laws respecting trade with Cuba, the most acrimonious area of extraterritorial dispute between Canada and the U.S., has not depended on residency of directors. That Act prohibits any "U.S.-owned or controlled firms" from trading with Cuba. That term does not appear to be defined but focuses on ownership and not how the board is structured.

Therefore, the directors' residency requirement does not limit the extraterritorial application of foreign laws. However, the residency of directors may be relevant to the enforcement of extraterritorial applications of foreign laws and Canadian countermeasures.

The CBCA directors' residency requirement may impact on the enforcement of the U.S. Cuban Democracy Act of 1992 and related regulations and of FEMA and the order issued under it. The stiff U.S. penalties are presumably only realistically enforceable on U.S. citizens and residents: the parent corporation, its officers and directors and U.S. officers and directors of the Canadian subsidiary.

It appears that the U.S. regulations also purport to apply to the Canadian subsidiary and all officers and directors (including Canadian residents) of that subsidiary,. However, unless they are present or have assets in the U.S., any order would not be effective. A Canadian directors majority requirement may therefore limit the effectiveness of enforcement of U.S. extraterritorial laws, if the Canadian directors chose to ignore the U.S. rules. Apparently this was what happened in 1974 in the MLW Worthington Ltd. case, described above.

It is questionable, however, whether the directors of a subsidiary would risk the imposition of the severe U.S. penalties on the parent, the parent's officers and directors and the U.S. officers and directors of the subsidiary. The article, "World View [:] Don't let Washington call the shots", in The Globe and Mail, quoted above, indicated that in the case of at least two corporations faced

with the conflict between the U.S. and Canadian rules on trade with Cuba, the "head offices called the shots".

FEMA and parallel provisions under the Competition Act are most effective against residents of Canada (i.e. Canadian or foreign) and also Canadians in general who presumably have an attachment to this country . FEMA applies, by its provisions, to "persons in Canada". The Canadian incorporated company is a "person in Canada" as are resident Canadians directors. Foreign directors unless present in Canada would not be subject to FEMA.

A final point is the different penalty structures under the U.S. and Canadian rules. Because the U.S. penalties are more severe, an order under FEMA is less likely to be effective vis-a-vis the American rules.