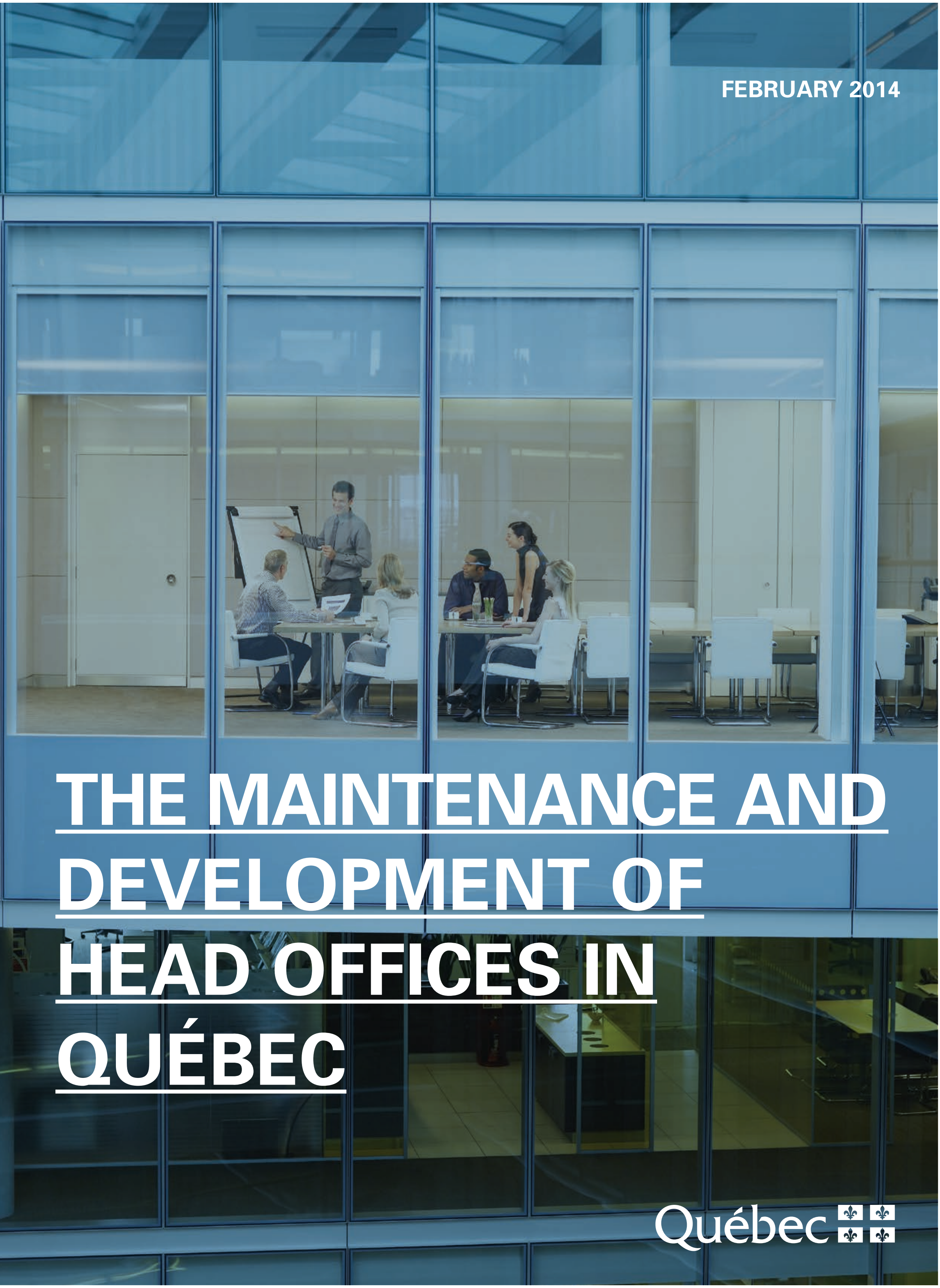
Task Force on the Protection of
Québec Businesses

FEBRUARY 2014



THE MAINTENANCE AND DEVELOPMENT OF HEAD OFFICES IN QUÉBEC

Québec

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Task Force on the Protection of Québec Businesses

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TABLE OF CONTENTS

LETTER OF TRANSMISSION FROM THE TASK FORCE

February 10, 2014

Mr. Nicolas Marceau
Minister of Finance and the Economy

Dear Minister,

On June 7, 2013, you assigned to the Task Force on the Protection of Québec Businesses a mandate to recommend measures to enable Québec firms to better protect themselves from unwanted takeover bids and measures to foster the maintenance and development of head offices in Québec.

At the conclusion of its meetings, analyses and reflections, the Task Force on the Protection of Québec Businesses is pleased to submit to you the report adopted unanimously by its members.

The Task Force wishes to thank you for the confidence that you have placed in it. It also wishes to thank everyone who agreed to participate in the consultations and the experts whose deliberations sustained its reflection. The Task Force would also like to emphasize the support of the Ministère des Finances et de l'Économie and the Autorité des marchés financiers in the course of its work and the drafting of this report. We hope that we have contributed constructive and promising recommendations under the mandate assigned to us.

Claude Séguin
Senior Vice-President
Corporate Development and Strategic Investments
CGI
Chair of the Task Force on the Protection of Québec Businesses

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SUMMARY

MANDATE

On June 7, 2013, Minister of Finance and the Economy Nicolas Marceau announced the establishment of the Task Force on the Protection of Québec Businesses and assigned to it a mandate to recommend measures to enable Québec firms to better protect themselves from unwanted takeover bids and measures to foster the maintenance and development of head offices in Québec.

Within the framework of the mandate, it was desirable to clearly illustrate the economic and social importance of head offices established in Québec.

THE IMPORTANCE OF HEAD OFFICES

In 2011, there were 578 head offices in Québec. Overall, they generated over $5 billion in economic activity. Over 400 of the head offices are located in the Montréal area and directly employ over 42 000 people, out of a total of 50 000 in Québec, and account for most of the 20 000 jobs among suppliers and specialized firms, in particular accounting, financial, legal, computer and telecommunications services. They assemble the company's senior executives and pay remuneration that is double the average wage in Québec.

Head offices attract a wide array of specialized services, whose presence helps to attract other head offices. They are also contributing to the expansion of the commercial building inventory and are promoting the operations of hotels, restaurants and the entertainment sector. Moreover, they are enabling Montréal to benefit from greater numbers of direct air links than the catchment population alone would allow.

Head offices also have considerable impact on the charitable and cultural sectors through their financial contributions and participation by their staff.

In short, head offices make a substantial economic and social contribution and their maintenance and development in Québec's territory strikes the members of the Task Force as being of major importance for Quebecers' well-being and prosperity.

THE VULNERABILITY OF HEAD OFFICES

Most companies that maintain a big head office in Québec are listed on the stock exchange. Going public confers significant benefits on corporations, in particular by making it possible to raise the capital required for their development, although it also implies constraints. Public corporations are particularly likely to be subject to takeover bids that are unwanted or hostile but that a majority of shareholders might wish to accept. Contrary to the situation in a number of jurisdictions in North America, the legislation, regulations and directives in force not only in Québec but also in Canada as a whole allow wide latitude for takeover bids, even hostile ones. The boards of directors of the companies targeted have little leeway to oppose the bids when they deem it appropriate to do so.

The founders of certain companies that have become public corporations have taken precautions against hostile takeovers by maintaining sufficient voting rights to maintain control, often by means of multiple voting shares. However, such strategies have their limitations and the need for capital often leads the founders to abandon such control.

The Task Force believes that too many head offices are vulnerable to takeover bids that are attractive in the short term to the shareholders but that would cause significant economic losses for Québec. It therefore recommends that additional means be accorded public corporations and their boards of directors to counteract a takeover bid that they deem to run counter to the corporation’s interests, in particular as regards its long-term survival.

It is in this context that the Task force is recommending to the Minister of Finance and the Economy measures that would enable businesses incorporated pursuant to Québec legislation to better defend themselves against hostile takeover bids insofar as they wish to do so. This “toolchest” for public corporations that rely on it seeks to make essential the consent of the board of directors of the corporation subject to a takeover proposal.

At the outset, based on the example of certain European legislations, the Task Force is proposing to give the corporations that so desire the choice of including in their articles of incorporation voting rights that vary according to the duration of detention of the shares. This measure seeks to attribute greater decision-making power to the shareholders who have long-term interests in the corporations targeted.

The Task Force also suggests amending the Québec *Business Corporations Act* (CQLR, chapter S-31.1) (QBCA) in order to include in it provisions that allow for the prohibition of certain operations in the case of corporations subject to a takeover bid not approved by the board of directors. The new provisions, which draw inspiration from American legislation, might dissuade potential buyers from making bids without first obtaining the consent of the boards of the directors of the corporations targeted.

The first two series of provisions would be applicable to any entity incorporated in Québec likely to make a public issue and be subject to a hostile takeover bid. The Task Force therefore recommends that the same tools be accorded issuing entities governed by the *Civil Code of Québec* (CCQ 1991) such as certain trusts.

The Task Force also believes that it is necessary to recommend the restructuring of the Bureau de décision et de révision so that the latter becomes a specialized administrative tribunal comprising judges from the Court of Québec. This measure would enhance the perception of the quality of the decisions that Québec judicial bodies hand down in the realm of securities, which should heighten the interest among firms in establishing their head offices in Québec.

The recommendations would obviously be more effective were they accompanied by a sweeping review of the directives that Canadian Securities Administrators apply, in particular when dealing with the shareholder rights plans that a board of directors may implement to defend the corporation against an unwanted takeover bid. Over the past year, the Autorité des marchés financiers du Québec (the Autorité) has made constructive proposals to this effect that would enable corporations that are subject to a hostile takeover bid to have access to the means of defence available to most American corporations. The Task Force strongly supports the position of the Autorité and recommends to the Minister of Finance and the Economy that he examine the legislative or regulatory changes that might facilitate the implementation of the proposals of the Autorité des marchés financiers.

MAKE QUÉBEC MORE COMPETITIVE

The Task Force is aware that the loss of head offices does not stem solely from unwanted takeover bids. When a head office leaves Québec because the corporation's management, with the consent of its board of directors, believes that the economic and social environment for corporations is unfavourable there, that the taxation system is not competitive, or, simply, because it concludes that it is better to sell, the loss is also just as harmful to the province's economy. That is why the Task Force felt it was advisable to recommend three tax measures that, were they adopted, would significantly alter the environment in which head offices in Québec operate.

The first measure seeks to make it fiscally more advantageous for employees to purchase the shares of a corporation. Not only would the employees become owners but, over the years, employee share ownership might prove to be a useful means of countering a hostile takeover bid.

The second fiscal measure aimed at reviewing the tax treatment of gains from stock options would enable Québec to regain its tax competitiveness as regards the senior executives of companies who normally reside where the head office is located. The current situation makes it difficult to recruit senior executives from outside Québec and strongly encourages those who reside in Québec to live elsewhere. The situation largely reduces the economic impact of our head offices and does not foster their development.

The Task Force recommends as a third measure that the Minister modify the application of the taxing statutes when a shareholder who controls a corporation dies. Under the existing taxation system, substantial taxes are levied upon the shareholder's death even if the shares are not sold, which may bring about the sale of the business to pay such taxes. The taxation could be deferred, as is the case in several European States, or in Québec in the agricultural sector, as long as the heirs maintain ownership of the business. Ownership by Quebecers of businesses could thus be maintained for several generations.

Lastly, the Task Force recommends that the Minister reassess the financial resources made available to investment funds in Québec, including those that benefit from tax assistance, and the investment constraints applicable to them, such that the funds are better able to participate in the transmission of ownership of businesses to the next generation of Québec owners.

CONCLUSION

The Task Force is aware that it had only a few months to engage in a detailed examination of each of the recommendations and that further deliberation is needed to ensure that they can be applied with desirable efficiency. Together, they could make available to Québec corporations a sufficiently robust “toolchest” to enable the boards of directors of such corporations to make the decisions that they deem to be in the company’s best long-term interests. They might encourage even greater numbers of corporations to incorporate or continue in Québec, establish operations and develop here. A Québec that welcomes senior executives guarantees the maintenance in Québec of head offices and the broadening of their economic and social impact on Québec society.

RECOMMENDATIONS

The Task Force therefore wishes to make to the Minister of Finance and the Economy the following recommendations concerning the protection of head offices in Québec.

Recommendations respecting the Québec *Business Corporations Act*

1. Amend the Act to make possible the adoption of variable voting rights according to the length of time that the shares of corporations are held. The Task Force proposes the following implementation formula:

   — the voting shares of the corporation may include an additional voting right when the veritable owner has held such shares for two years or more.

     — The measure stipulated could be included in the articles of constitution of the corporation.

     — It might also be introduced into the corporation’s articles of incorporation subsequent to its incorporation or be withdrawn at any time by special resolution of the shareholders, in which case the shareholders could exercise their usual rights.

2. Amend the Québec *Business Corporations Act* to allow for the adoption of provisions to prohibit certain transactions by corporations subject to a takeover bid not approved by the board of directors. The Task Force proposes the following implementation formula:

   — a merger or other amalgamation of the assets of the corporation with those of the offeror or a substantial sale of assets representing 15% of the corporation are prohibited for five years;

   — the offeror must give to the corporation the profits made in the 24 months following the takeover bid on the of resale of the shares of the corporation purchased during the 12 months preceding the launching of the takeover bid;

   — the revocation of the term of office under way of a director (of a maximum duration of three years) may not occur before the end of his term;

   — the offeror may not exercise its voting right in respect of the shares that it holds after the launching of the takeover bid. This measure will apply until the other shareholders, excluding the directors and the manager-shareholders, adopt a resolution with two-thirds of the votes restoring the voting rights to the initiator of the takeover bid and persons related thereto;

— the measures stipulated above could be included in the articles of constitution of the corporation;

— they might also be introduced into the corporation's articles of incorporation subsequent to its incorporation or be withdrawn at any time by special resolution of the shareholders, in which case the shareholders could exercise their usual rights.

3. Measures similar to those stipulated in recommendations 1 and 2 should be applicable to all entities incorporated in Québec likely to make a public issue and be subject to a hostile takeover bid. Accordingly, they should be applicable to issuing entities governed by the *Civil Code of Québec,* such as certain trusts.

Recommendations concerning securities regulators

4. The Task Force supports the proposal of the Autorité des marchés financiers to allow the board of directors of corporations that are subject to a hostile takeover bid to fully exercise their fiduciary duties and believes that the proposal, insofar as it is applied to all companies listed on the stock exchange that are reporting issuers in Canada could restore balance between the initiator of the unsolicited takeover bid and the offeree. In this perspective, the Task Force recommends that the Minister of Finance and the Economy determine whether legislative or regulatory amendments might facilitate such an implementation of the Autorité's proposal.

5. Convert the Bureau de décision et de révision into a specialized administrative tribunal comprising judges from the Court of Québec. The structure of the tribunal could draw inspiration from the Professions Tribunal.

The development and long-term survival of head offices

6. Make provision for more advantageous tax treatment that encourages the employees of corporations listed on the stock exchange to hold shares by deferring the taxation of the employees to the time of sale of the shares instead of the time of their acquisition.

7. Grant tax treatment of the gains on stock options that is more favourable than elsewhere in Canada to maximize the development of head offices and the attraction and retention of senior executives to Québec or at least harmonize such tax treatment with the other Canadian provinces.

8. Reassess the Québec taxation system to allow the owners and major shareholders of a company to defer the taxation of the gain on the transmission of ownership of a corporation to another generation and introduce a measure that allows family trusts to defer the realization of the gain attributable to their significant investment in a company at the time of its sale rather than every 21 years, as long as the business remains active.

9. Promote the financial and operational participation of Québec investment funds to facilitate the transmission of Québec corporations to a new generation of Québec owners and, consequently, examine the requisite legislative and regulatory amendments.

INTRODUCTION

On June 7, 2013, Minister of Finance and the Economy Nicolas Marceau announced the establishment of the Task Force on the Protection of Québec Businesses with a mandate to examine the measures to be implemented to enable Québec firms to better protect themselves against unwanted or hostile takeover bids and to promote the maintenance in Québec of head offices.

THE MANDATE ASSIGNED BY THE GOVERNMENT

The Task Force received a mandate to:

— examine the legal framework that would make it possible to better ensure the maintenance of decision-making centres and business development in Québec;

— study the defensive measures in force in the American states and elsewhere in the world;

— examine the nature, scope and impact in the medium and long terms of measures to promote the maintenance of head offices;

— examine the question of intervention by board of directors and the free exercise of their fiduciary duties when unsolicited takeover bids are made;

— submit proposed legislative amendments that would enable Québec firms to better protect themselves against unwanted takeover bids and promote the maintenance in Québec of head offices.

Claude Séguin, Senior Vice-President, Corporate Development and Strategic Investments at CGI, chaired the Task Force, supported by seven members with an array of expertise:

— Raymonde Crête, Professor, Lawyer and Director of the Financial Services Law Research Group, Faculté de droit, Université Laval;

— André Dion, FCPA and former President and Chief Executive Officer of RONA and Unibroue;

— Monique Jérôme-Forget, Special Advisor, Osler & Harcourt, LLP and former Minister of Finance of Québec;

— Michel Leblanc, President and Chief Executive Officer, Board of Trade of Metropolitan Montreal;

— Andrew Molson, Vice-Chairman, Molson Coors Brewing Company;

— Éric Morisset, Vice-Chairman, Quebec Market, TD Bank Group, Head, Investment Banking, Quebec, TD Securities Inc.;

— Robert Paré, Partner, Fasken Martineau DuMoulin LLP.

CONTEXT IN WHICH THE ESTABLISHMENT OF THE TASK FORCE WAS ANNOUNCED

The question of safeguards against unwanted takeover bids became especially important during the summer of 2012 when Lowe's, an American company, informed the board of directors of the RONA hardware chain of its intention to buy the company.

Although Lowe's did not carry out its proposed acquisition, the event highlighted the vulnerability of a number of companies regarded as Québec flagships when faced with unwanted takeover bids.

Certain observers in Québec suggested at that time that the government draw inspiration from regulations in force in the United States to enhance the protection of Québec public corporations[1] against hostile takeover bids.

At the time of the announcement of the establishment of the Task Force on the Protection of Québec Businesses, the Autorité des marchés financiers (the Autorité), in cooperation with the Canadian Securities Administrators (CSA), engaged in consultations on a proposed amendment to the regulations applicable to takeover bids and shareholder rights plans so that they better respond to current market conditions (CSA project).

At the same time, the Autorité published, for consultation purposes, its own proposal focusing on more substantial amendments to the overall regulations applicable to takeover bids (the Autorité's project).

LIMITATIONS OF THE MANDATE

Given its concern to ensure the maintenance and development of head offices in Québec and support an open economy receptive to investments, the government assigned to the Task Force a mandate to determine the appropriate measures to provide Québec businesses targeted by unwanted takeover bids with more effective means to defend themselves. In light of the mandate, the Task Force's recommendations focus, first and foremost, on the problem of the vulnerability of businesses in the specific context of unwanted takeover bids.

However, the Task Force believes that the problem of attracting and retaining head offices largely exceeds the question of takeover bids alone. It has, therefore, included a number of observations and suggestions respecting various economic measures that may, in its opinion, contribute to the expansion of head offices in Québec.

1 In this report, the terms "businesses," "corporations" and "public corporations" refer to private-sector firms whose shares are sold on the stock market through public offerings. We can also refer to the notion of reporting issuer pursuant to securities legislation (see the section entitled "Characteristics of public corporations").

THE TASK FORCE'S APPROACH

In its approach aimed at drafting a concise, enlightened report, the Task Force benefited, in addition to the professional experience of its members, from the support of distinguished collaborators and professionals and the analysis of numerous studies, articles, comments and opinions.

In order to specifically illuminate certain facets of the mandate, the Task Force commissioned several additional studies, in particular on the importance of head offices in Québec, the protective measures applied elsewhere in the world, and the economic impact that such measures can have on the value of businesses.

The Task Force also consulted businesspeople, economists, jurists, financiers, the representatives of organizations interested in governance, institutional investors and company executive officers or directors. The consultations focused on questions related to the control of Québec firms and the long-term survival of head offices, in particular when an unsolicited takeover bid is made.

The report is based on the studies and consultations.

THE PLAN OF THE REPORT

The report briefly takes stock of the economic and social contribution that Québec head offices make and offers a comprehensive overview of business acquisitions involving Québec companies.

It then pinpoints the companies most vulnerable to hostile takeover bids and the risks of losing a head office as soon as a corporation is targeted by a takeover bid.

The report briefly reviews the legal and economic considerations that particularly attracted the attention of the members of the Task Force.

It then presents the protective measures contemplated, accompanied, in some instances, by the Task Force's comments.

The report concludes with the presentation of the Task Force's viewpoint, followed by its recommendations to the Minister of Finance and the Economy.

HEAD OFFICES AND THE QUÉBEC ECONOMY

For several years, there has been a perception that Québec is losing head offices, whose ownership and operations are gradually being transferred outside Québec. This gradual loss of control over our enterprises appears to occasionally occur through private transactions that attract little attention, and other times through more visible transactions.

While hostile takeover bids by foreign firms aimed at Québec corporations are not very frequent — indeed, there have only been seven such bids in the last 12 years — they undoubtedly fall into the category of highly visible transactions. Widespread media interest was apparent, in particular, when the American company Lowe's indicated its intention to buy RONA, regarded for a long time as one of Québec's major businesses. The prospect of losing control over the company raised numerous questions on Québec's ability to create, attract and, above all, maintain head offices here.

If the question concerning the protection of head offices within the framework of hostile takeover bids perhaps represents only one aspect of the problem of maintaining company decision-making centres in Québec, it is certainly one of the most visible aspects and it is important to examine it closely. In a business community that is developing in an international context, the perception of the economic, social and legal characteristics of different host countries for businesses undoubtedly represents a key element to promote Québec as a location of choice.

Against a backdrop of keen competition between States, it is of the utmost importance to fully grasp all of the factors that come into play in order to maximize Québec's ability to develop, attract and maintain head offices with their decision-making centres and economic spinoff. To this end, we must first establish a comprehensive overview of the current situation in Québec and trends in recent years.

DEVELOPMENT, CONTRIBUTION AND EXPANSION OF HEAD OFFICES IN QUÉBEC

To sustain its reflection on the mandate assigned to it, the Task Force asked KPMG-SECOR, an independent strategic management consulting service, to take stock of mergers and acquisitions that affect Québec companies and the development of decision-making centres located in Québec, and to review and, as much as possible, quantify the types of advantages that stem from the presence of head offices. Here are the key findings of the study.[2]

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[2] SECOR-KPMG, *Les sièges sociaux au Québec – Leur évolution, leur contribution et leur expansion, Présentation du rapport d'analyse réalisée pour le Groupe de travail sur la protection des entreprises québécoises*, November 7, 2013.

Recent purchases and sales of Québec public corporations

To conduct its analysis of recent purchases and sales of Québec public corporations, KPMG-SECOR first examined all transactions of over $1 million between January 2001 and July 2013.[3]

The analysis reveals, in particular, that when account is taken of the sale and purchase of businesses and divisions of businesses, the value of assets is balanced.[4]

Among the 671 transactions inventoried for the study covering the period from January 2001 to July 2013, barely 2% of the bids can be deemed unwanted or hostile, which represents 14 transactions all told, seven of which Québec firms initiated. Of the seven attempted unwanted takeovers of Québec firms by foreign companies, none was completed by the initiator. However, in three cases, the hostile takeover bid ultimately led to the sale of the company.[5]

Profile of and changes in head offices located in Québec

In the context of the KPMG-SECOR study, the term "head office" is defined as the establishment of a company whose main activity consists in supplying its affiliated establishments with general management or administrative support services. The analysis presented in the study focuses on the number of and changes in the head offices of domestic and foreign public and private corporations located in Québec and in Canada. The information compiled is drawn essentially from official Statistics Canada data, the enterprise register, and the FP500.[6]

The KPMG-SECOR study reveals that in 2011, there were 578 head offices in Québec that directly employed 51 276 people and, indirectly, nearly 20 000 people among the suppliers of the head offices. The impact on Montréal is considerable since over 400 of the head offices are located there and 42 000 jobs are directly linked to them. The Montréal area accounts for over 70% of such establishments, followed by the Québec City area, with 10%. There are, on average, 104 jobs per head office in the two areas.

In relation to the country overall, Québec accounts for 20% of the head offices inventoried, which corresponds to Québec's economic weight in Canada, and it ranks second in terms of the number of head offices,[7] the resulting jobs[8] and the number of jobs per head office.[9]

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3 The transactions analyzed are drawn from the Bloomberg data bank. The Québec data were not adjusted in order to compare the Canadian provinces.

4 A net positive balance of $0.5 billion.

5 In 2007, an unsolicited takeover bid by Alcoa led to the sale of Alcan to Rio Tinto; in 2004, an unsolicited takeover bid from Telus led to the sale of Microcell to Rogers; in 2009, an unsolicited takeover bid from Noront Resources led to the sale of Freewest Canada Resources to Cliffs Natural Resources.

6 The list of the 500 biggest Canadian companies according to the *Financial Post*.

7 Second to Ontario.

8 Second to Ontario.

9 Second to Alberta.

The economic and distinctive contribution that head offices make

Five major kinds of economic benefits stem from the operations of head offices.

1. Head offices are noteworthy for the quality of the jobs that they offer since they employ a significant proportion of highly qualified individuals in well-paid positions, i.e. roughly twice the average remuneration in Canada.

2. In order to support their operating activities, head offices rely on numerous specialized professional service firms, thereby contributing to the latters' development. Conversely, the presence of such firms, which also offer highly paid jobs, contributes significantly to the attraction and retention of head offices.

3. The concentration of head offices in a population centre is a source of prestige and attracts business visitors, which leads, among other things, to an increase in and the enhancement of the commercial building inventory and the stimulation of the accommodation, restaurant and entertainment sectors.

4. The presence of head offices can foster or stabilize other local business operations. For example, some research and development activities are often located near the head office and, when a company restructures, local operations are usually affected to a lesser extent.

5. Head offices also have a considerable impact on charitable organizations in their region since they financially support several organizations both in the realms of culture and sports and in the health and social services sector, and encourage participation and volunteer work among their employees. The importance of the combined donations of businesses and their employees stems, in particular, from the concentration of donations from certain businesses in the community that hosts their head office, the place of birth, learning and retirement of senior executives or the founders, and a desire to give back to the host community for the success obtained.

In short, in 2011, head offices generated over 70 000 jobs in Québec. For each job related to corporate functions, 3.5 additional jobs have been generated in respect of internal administrative support services (shared or other services) and nearly two other jobs as regards outside suppliers.

Overall, the operations of head offices engendered $5.1 billion in wealth creation in 2011, i.e. over $3.6 billion stemming directly from operations in the head office and over $1.5 billion stemming from purchases from Québec suppliers such as accounting, financial, legal, computer and telecommunications services.

Usually, when a Québec firm acquires other businesses, this leads to the addition of new management functions in the head office, the implementation or expansion of shared services located in Québec covering financial, human resources and computer services, more extensive administrative support activities carried out in Québec, and the concentration of procurement of goods and services from other Québec firms.

On the other hand, when a Québec firm is purchased, this leads to a reduction in the number of jobs in the wake of the transformation of the role of the head office, the elimination of operations related to shared financial services, a reduction in the number and volume of Québec products that the company distributes, and a reduction in the purchase of professional services from Québec suppliers.

This section of the study confirms the vital role that head offices play in the Québec economy and the economic impact that their disappearance can have.

Factors that govern the development of head office operations and possible avenues for improvement

Based on the experience of KPMG-SECOR, secondary research and interviews with senior executives, this section establishes the key factors that influence head office operations and suggests certain relevant avenues for improvement in Québec.

It is first essential to grasp that the core mission of a head office is to create value in the establishments that it governs. Its organization, choice of location and decisions are subordinate to this objective.

Its performance will depend directly on the individuals who work there, access to quality external services and its ability to interact constantly with the entities governed, hence the importance of an environment with adequate infrastructure, human resources and key suppliers.

The main criteria respecting the location of a company can usually be divided according to their desired impact on two key dimensions of the operations of a decision-making centre, i.e. the impact on the quality of management of the company and the impact on control over operating costs.

Greater importance is usually attached to the quality of governance, which depends on the ability to hire locally or attract top-notch human resources, integration into major business networks, ease of access to strategic external services, the quality of telecommunications infrastructure, and access by air. Cost control essentially affects after-tax costs, corporate taxation, ease of operating, including regulatory matters, and the support of public administrations from an economic and political standpoint.

In the search for the optimum location, the importance of the accessibility of qualified manpower is such that businesses must, first and foremost, consider the employees' viewpoint both in respect of the overall quality of the jobs and as regards the actual remuneration offered. For example, decisive factors in the quality of jobs can include prospects for advancement, occupational integration, family integration, and the quality of life in general. Actual remuneration will depend essentially on gross remuneration, personal taxation and the cost of living.

Whether the viewpoint of the business or its qualified workers is considered, the reputation and perceptions of a city or region are similar in many ways to a trademark and contribute markedly when the city or region is considered or overlooked as an ideal site for a head office. Such perceptions are often decisive and usually take a long time to alter.

Obviously, several other causes can explain the relocation of a head office. The four key ones are:

1. a decisive external shock for the company, such as a significant change in the structure of share ownership or purchase by a foreign company;
2. a major change in the company's business environment, such as a geographic or sectorial shift in markets or a significant shift in the centre of gravity of the firm's operations;
3. very significant deterioration in local conditions, in particular the local economic situation or growing difficulties in hiring and retaining the requisite key personnel;
4. a strategy to position the firm that may sometimes imply relocating the head office to signify a strategic repositioning, strong growth, or a major merger or acquisition.

For several years, the growing mobility of individuals and businesses has steadily become more pronounced. Since the creation of wealth by a small open economy depends primarily on its human resources and the ability of its firms to develop their presence on foreign markets, Québec must ensure that it can attract and retain talent in its territory and facilitate the internationalization of the companies located here.

Thus, it appears that Québec's natural advantages have diminished, in particular from the standpoint of demographics, energy and natural resources. At the same time, regions that compete with Québec have reduced the gap in respect of several other advantages that Québec has acquired over the years, such as the quality of life, support for businesses, and support for industrial clusters. Broader convergence is exacerbating the real or perceived negative impact of weaknesses. It is important to mitigate weaknesses, develop countervailing benefits and better manage perceptions of Québec's characteristics.

Among the avenues for improvement suggested by the individuals consulted, several emphasized the overall bolstering of the Québec economy as a basic condition for success. In particular, this can be accomplished by the strengthening of investment in education, the pursuit of the development of Québec's strengths, the facilitation of the expansion and internationalization of businesses, the retention of foreign students, broader promotion of entrepreneurship, and an approach centred overall on economic development.

More specifically, the maintenance of a competitive personal taxation system, the pursuit of efforts to attract and integrate newcomers, the enhancement of the quality of public services, the establishment of better air connections and the promotion abroad of the attractions of major urban centres such as Montréal and Québec City have been pinpointed as decisive factors to maintain and develop existing head offices.

In order to attract new head offices, it was also proposed to adopt a highly targeted approach focusing on Québec's strengths, support teams from foreign companies that engage in significant operations in Québec, and develop local ambassadors.

In particular, the Task Force has noted that the factors directly affecting individuals are very often decisive for the maintenance and development of head office operations. The management and performance of head offices depend primarily on the people who work there. The ability to attract and retain the best employees is a key factor. To this end, the Task Force notes that head offices make it possible to assemble on one site the senior executives of the company, pay the highest wages and, in the case of international corporations, attract executives from around the world.

THE VULNERABILITY OF QUÉBEC PUBLIC CORPORATIONS

Head offices are vulnerable to hostile takeover bids

Before the Task Force makes recommendations on desirable protective measures, it is important to determine the pool of Québec corporations likely to be subject to an unwanted takeover bid. The Task Force used as a reference the work of Yvan Allaire, Chairman of the Board of Directors of the Institut sur la gouvernance d'organisations privées et publiques (IGOPP) in *Les prises de contrôle de sociétés québécoises : enjeux et pistes de solution.*[10]

An examination of the 50 biggest Québec corporations listed on the stock exchange[11] reveals that 18 corporations are currently protected since they are controlled by one shareholder or related shareholders,[12] including Bombardier, Power Corporation of Canada, CGI Group, Quebecor, Jean Coutu Group, Alimentation Couche-Tard, Cogeco, Saputo and Transcontinental.

In addition, six corporations are protected against foreign takeovers because of the legislation that governs them in certain key sectors such as banking, insurance, telecommunications and air transport, in particular National Bank, Laurentian Bank, Industrial Alliance, BCE, Air Canada and Transat. CN, which possesses specific articles of incorporation that afford it some protection, can also be added to the list.

Accordingly, 25 corporations with a head office located in Québec remain more vulnerable to an unwanted takeover bid, of which only eight public corporations are incorporated under Québec legislation, i.e. Metro, Cominar, Quincaillerie Richelieu, RONA, Amaya, Semafo, Uni-Sélect and Canam, while 17 other corporations are incorporated under Canadian legislation, e.g. SNC Lavalin, Dollorama, Gildan, CAE, Transforce, Osisko, Resolute Forest Products and WSP Global Group.

The Task Force concurs that all of the recommendations concerning protective measures applicable pursuant to Québec legislation will mainly have an impact on corporations that are already incorporated and those that will incorporate under the legislation. Such firms could thus be the first beneficiaries of the additional means that might be authorized by amended Québec legislation.

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10 Yvan Allaire, *Les prises de contrôle de sociétés québécoises : enjeux et pistes de solution*, November 2, 2012, tables updated in November 2013.

11 The ranking is determined according to stock market valuation.

12 The notion of control refers here to any situation in which a shareholder or related shareholders hold over 33% of the total votes.

Takeover bids that target Québec corporations

Experience in recent years has shown that in fact no unwanted or hostile takeover bid launched by a non-Québec offeror has led to the acquisition by the offeror of the Québec firm. However, three Québec firms thus “put into play” have ultimately been sold, i.e. Alcan, Microcell and Freewest Canada Resources.

The Task Force has also noted that unwanted takeover bids by Québec firms in respect of other Québec firms have all been completed.[13] Among these transactions, the acquisition of Fibrek by Resolute Forest Products clearly illustrates the current limitations of the means of defence in the context of an unsolicited bid.

In November 2011, AbitibiBowater, which now operates under the name Resolute Forest Products (Resolute), announced its intention to launch an unsolicited takeover bid to acquire all of the issued and outstanding shares of Fibrek, a company incorporated under federal charter located in Québec.

The corporation thus having been “put into play,” its board of directors adopted a shareholder rights plans to gain additional time to seek a higher bid. In January 2012, Resolute asked the Bureau de décision et de révision (BDR) to issue a cease trade order in order to lift the rights plan. In early February 2012, Mercer International (Mercer) agreed to play the role of the white knight.

Despite the imminence of the other offer that would have been more advantageous and the support of the Autorité des marchés financiers for the position of Fibrek and Mercer, the BDR issued a cease trade order, thus favouring Resolute’s offer.

At the request of Mercer, the decision was quashed on appeal before the Court of Québec. However, at the request of Resolute, the BDR’s decision was restored by the Court of Appeal of Québec because, by relying on the evidence presented, the BDR’s decision could not be deemed unreasonable.

Were it not for the cease trade order issued by BDR and the impossibility of properly defending itself, Fibrek could have obtained a better offer than that of Resolute or even decided to reject any bid in order to pursue its long-term plans. Consequently, the Task Force believes that the judicial decisions in this case raise both serious questions on the consequences of Canadian regulations and on the interpretation of such regulations by the BDR in Québec.

Recent trends on financial markets

A widespread perception by stakeholders in the business community is that the adoption of an approach increasingly centred on the short term by big institutional investors poses a challenge for healthy governance and business efficiency. The interests of shareholders with a long-term perspective and those of more speculative “investors” can then conflict.

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[13] In 2011, an unsolicited takeover bid from the Fonds d’investissement Cominar led to the acquisition of Fonds de placement immobilier Canmarc; in 2011, an unsolicited takeover bid from Resolute Forest Products led to the acquisition of Fibrek; in 2002, an unsolicited takeover bid from CGI Group led to the acquisition of Cognicase.

Generally speaking, such short-term speculative behaviour is associated with a relatively recent category of “alternative” investors such as hedge funds, which implement multiple investment strategies linked less to the characteristics of businesses as such than to notions of volatility, absolute return, market risk management, and special situations or opportunities. There are several categories of funds, including arbitrage funds that focus primarily on very short-term investments.

The widespread presence of investors with considerable financial resources and such a short-term perspective can adversely affect public corporations, in particular given that the launching of a takeover bid usually affords an opportunity to quickly make a profit.

One characteristic of this new type of investors, whose involvement has grown considerably in recent years as regards the funds that they manage, is to develop an array of complex investment strategies and products commonly known as “structured” products. The shares of companies held under the strategies are then used as “ingredients” to manufacture the products and have little to do with the performance of the underlying corporation. In many cases, such use of the shares contributes to the dissociation of the ownership of the shares and the economic benefit usually associated with it. Investors who create such products have little interest in long-term prospects for creating value in the companies whose shares they own. However, when the time comes to make important decisions for a corporation, this type of investor benefits from the same rights as the investors who have an interest in the long-term success of the corporations’ plans.

Furthermore, institutional investors, pension funds and pooled investment funds represent a growing share of the ownership of big public corporations. According to the data obtained by the IGOPP, share ownership by institutional investors as a proportion of US market capitalization now appears to exceed 70%.[14] While they are not activists to the same extent as hedge funds or arbitrageurs, they negotiate on stock exchanges with increasing rapidity a significant portion of the shares that they hold.

Accordingly, “the average holding period of shares, influenced by trading games and fund management strategies, began to drop in the 1980s from an average 5-6 years to less than one year nowadays for the New York Stock Exchange”[15], and the same is true of other major stock exchanges.[16]

Bearing in mind that the sale of the corporation is one of the measures that can maximize the value of shares in the short term, it is unsurprising that alternative shareholders interfere in takeover bids. In particular, in the case of a hostile takeover bid, the interest of hedge funds and arbitrageurs are usually in line with the interests of the offeror or subsequent offerors that might raise the bid. Under

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14 Working Group on Compensation of IGOPP, Policy Paper prepared by professor Yvan Allaire, *Pay for Value: Cutting the Gordian Knot of Executive Compensation*, 2012, page 29. See also Yvan Allaire and Mihaela Firsirotu, *A Capitalism of Owners: How Financial Markets Destroy Companies and Societies and What To Do About It*, Institut sur la gouvernance d’organisations privées et publiques, January 2012, pages 68-69.

15 Working Group on Compensation of IGOPP, *op. cit*., page 30.

16 *Id*., page 31.

the circumstances, regardless of the source of the bid, it becomes essential for this type of investor that the corporation actually be sold.

What is more, it often happens that in the case of the announcement of a possible takeover bid, a significant proportion of the offeree's shareholders take advantage of the jump in the share price and sell their shares in the days following the announcement of the bid without waiting for the formal launching of the takeover bid. Consequently, a significant proportion of shareholders who will or will not tender their shares, as the case may be, or vote at the shareholders' meeting in response to the takeover bid, will have only held their shares for a few weeks.

Under the circumstances, it is readily apparent that such investors do not in any way wish for the establishment of a long-term shareholder rights plans or any other measure of defence that might prevent an unsolicited takeover bid.

Even if the Task Force deems it important for all shareholders in a corporation to be able to express an opinion on important decisions pertaining to the corporation, within the framework of current financial market trends, it would be advisable to accord greater weight to the positions of shareholders who have held their shares over a longer period of time. Variable control according to the duration of ownership would make it possible to attribute greater relative weight to shareholders who have a longer-term position in the corporations' share ownership.

According to the members of the Task Force, it is inconsistent during a hostile takeover bid for new speculative shareholders to express an opinion on possible means of defence in the same way as shareholders who have owned shares in the corporation for several years.

REGULATIONS GOVERNING TAKEOVER BIDS

This section seeks to briefly take stock of the judicial considerations that attracted the attention of the members of the Task Force in its examination of problems related to takeover bids and hostile takeover bids.

THE LEGAL ENVIRONMENT OF PUBLIC CORPORATIONS

The Task Force first focused on the legislative and regulatory provisions that currently apply to the corporations that its mandate covers. Without undertaking a detailed review of the legislation applicable to such a situation, this section briefly takes stock of the key legislative provisions that the Task Force considered in its study.

Bearing in mind that the Task Force is interested more specifically in the question of unsolicited takeover bids that target business corporation that have made public offerings, explaining the concepts in question is in order.

In Québec, business corporations are governed by the *Business Corporations Act* (CQLR, chapter S-31.1) (QBCA), and in an auxiliary manner by the *Civil Code of Québec* (CCQ 1991) (CcQ). At the federal level, they are governed by the *Canada Business Corporations Act* (R.S.C. (1985), chapter C-44) (CBCA). With the coming into force in 2011 of the QBCA, the rules governing Québec and Canadian corporations became more closely aligned. While there still are differences, most of the rules concerning Québec corporations presented in this section will generally be similar to those applicable to federally incorporated companies.

When a corporation makes a public offering in order to obtain additional capital and achieve some flexibility to enter the mergers and acquisitions market,[17] the choice engenders certain obligations.

— By thus becoming a reporting issuer within the meaning of section 68 of the *Securities Act* (CQLR, chapter V-1.1) (LVM), the corporation is subject to the continuous disclosure requirements. This obligation seeks to ensure greater transparency and to enable investors to make an enlightened choice based on the most reliable, complete information possible on the issuer.

— In the same way, reporting issuers are subject to monitoring by the Autorité des marchés financiers and the decisions of the Bureau de décision et de révision (BDR) pursuant to legislation and regulations governing securities. For example, an application may also be submitted to the BDR within the framework of an unsolicited takeover bid when the board of directors of the offeree adopts a takeover defence that might contravene the rules established in the realm of securities.

[17] Raymonde Crête and Stéphane Rousseau, *Droit des sociétés par actions*, 3e édition, Les Éditions Thémis, 2011, page 296.

— By enabling numerous investors to acquire its shares, the corporation significantly changes the dynamic respecting its governance. Indeed, greater numbers of shareholders will affect the administration of the corporation. While certain public corporations continue to have shareholders whose ownership is sufficient to effectively block an attempt at an unwanted takeover bid, others, with a more dispersed body of shareholders, are more vulnerable to such attempts. The initial public offering (IPO) thus represents the ideal time to make crucial choices for the governance of the corporation bearing in mind the prevailing requirements and constraints of capital markets.

In corporations with dispersed shareholders, the shareholders play a very limited role concerning the management of the corporation. In their capacity as investors, they are usually satisfied with providing capital while delegating business management to the directors and senior executives.[18] In principle, there exists a division between the body of shareholders and the business management of the corporation.

The key mechanisms for intervention by the shareholders of a public corporation are usually to examine at the annual meeting the management for the past year by the board of directors of the corporation's usual business. Such control is conducted, in particular, by means of financial statements and auditor's reports.[19] The shareholders are then asked to elect or re-elect the directors[20] and appoint an auditor for the coming fiscal year.[21] However, the shareholders may also be asked to meet at a special shareholders meeting convened by the directors[22] to vote on important questions that can fundamentally affect the corporation or shareholder rights.

Despite intervention by shareholders, it is the board of directors, in principle, that adopts most of the corporation's policy directions and decisions. The division between the ownership and management of businesses is thus real and can sometimes engender certain difficulties. Accordingly, a divergence may occasionally arise between the interests of the shareholders and the directors and senior executive that they appoint.[23] While, in the course of performing their duties, the directors are bound, first and foremost, to act in the best interests of the corporation,[24] the agency relationship[25] poses a threat to the sound governance of any corporation.

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18 *Id*., page 310.

19 QBCA, ss. 225 and 230.

20 LSQ, s. 110.

21 LSQ, s. 231.

22 QBCA, s. 207.

23 Raymonde Crête and Stéphane Rousseau, *op. cit*., page 312.

24 QBCA, s. 119.

25 Raymonde Crête and Stéphane Rousseau, *op. cit*., page 311: "the agency relationship raises a moral risk, i.e. a situation in which the senior executives are likely to pursue their interests to the detriment of the shareholders' interests in the performance of their duties." [TRANSLATION] See also Ejan Mackaay and Stéphane Rousseau, *Analyse économique du droit*, 2e éd., Paris and Montréal, Dalloz and Les Éditions Thémis, 2008.

THE LEGAL FRAMEWORK RESPECTING TAKEOVER BIDS

When a takeover bid is launched, the potential buyer asks the shareholders to tender their shares in exchange for cash or securities that usually represent a premium on the recent price of the shares held by the transferors.[26]

When a takeover bid[27] is launched, the directors of the issuer targeted must decide whether they recommend the acceptance or rejection of the bid or if they abstain from making a recommendation.[28] If, bearing in mind the corporation's interests,[29] they recommend the rejection of the bid, whether solicited or unsolicited, and the bid is maintained, such a bid will be deemed to be hostile.[30]

Regardless of the description of a takeover bid, the shareholders or securityholders are entirely free to follow or not follow the directors' recommendation and may tender or not tender their shares to the buyer according to the conditions stipulated in the bid.

This manner of taking control of a target corporation is governed by provincial securities legislation, in particular in Québec, by sections 110 *et seq.* of the *Securities Act.* The provisions respecting takeover bids refer, by and large, to *Regulation 62-104 respecting Take-Over Bids and Issuer Bids,* which is harmonized with provincial regulations elsewhere in Canada.

The main objectives of such regulation of takeover bids are to "ensure the equality of treatment of securityholders, the provision of adequate information to securityholders, and the transparency and impartiality of the bid process in order to avoid unfair discrimination between securityholders or pressure on them."[31] [TRANSLATION] It also seeks to "clearly, predictably structure takeover bids and discourage opportunism among the parties involved in takeover bids in order for them to make profits."[32] [TRANSLATION]

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26 Stéphane Rousseau and Patrick Desalliers, *Les devoirs des administrateurs lors d'une prise de contrôle : étude comparative du droit du Delaware et du droit canadien*, Montréal, Les Éditions Thémis, 2007, page 6.

27 Definition of a takeover bid: *Securities Act,* s. 110. ""Take-over bid" means a direct or indirect offer to acquire securities that is made by a person other than the issuer of the securities and that falls in a class of offers to acquire determined by regulation." and *Regulation 62-104 respecting Take-Over Bids an Issuer Bids* (CQLR, chapter V-1.1, r. 35) (Regulation 62-104), s. 1.1: ""take-over bid" means an offer to acquire outstanding voting securities or equity securities of a class made to one or more persons, any of whom is in the local jurisdiction or whose last address as shown on the books of the offeree issuer is in the local jurisdiction, where the securities subject to the offer to acquire, together with the offeror's securities, constitute in the aggregate 20% or more of the outstanding securities of that class of securities at the date of the offer to acquire but does not include an offer to acquire if the offer to acquire is a step in an amalgamation, merger, reorganization or arrangement that requires approval in a vote of security holders."

28 *Securities Act,* s. 113.

29 QBCA, s. 119.

30 Stéphane Rousseau and Patrick Desalliers, *op. cit*., page 8.

31 *Id*., page 50.

32 *Id*.

MEANS OF DEFENCE AVAILABLE TO BUSINESS CORPORATIONS

When an unsolicited takeover bid is launched and the board of directors recommends the rejection of the bid, the directors usually attempt to counter the hostile takeover by adopting defensive strategies aimed at thwarting any bid or, more specifically, the offeror's bid.

A shareholder rights plan, known as a poison pill, is the common takeover defence tactic both in Canada and the United States.[33] It is a measure that the board of directors can easily rely on since it can initially be adopted without the shareholders' consent. While there are several forms of shareholder rights plans, they usually consist in:

> the issue of rights to the current shareholders of the corporation that allow them to purchase for each share that they hold a new share in the corporation at a discount (usually half of the market value). The rights are exercised when a shareholder acquires the shares that grant him a percentage of share ownership that exceeds the limit allowed in the plan (typically 20%) without obtaining the approval of the board of directors or without complying with the conditions of the allowable bid described in the plan. The rights of the purchaser who triggers the exercising of voting rights are cancelled by the flip-in event.[34] [TRANSLATION]

When this measure is triggered, it dilutes the purchaser's interest such that it makes the acquisition so onerous that it can no longer be economically viable. In practice, the very presence of this possibility prevents the launching of a hostile bid, unless the offeror believes that it can obtain from the regulatory authorities the prohibition of the shareholder rights plan.

At present, the Canadian Securities Administrators (CSA) do not regulate the contents and form of shareholder rights plans. However, the CSA, and the Bureau de décision et de révision (BDR) in Québec, examine the plans on a case-by-case basis to determine whether it is necessary to prohibit them in the public interest.

To help it examine shareholder rights plans pursuant to its jurisdiction in the realm of the public interest, the BDR refers substantially to Notice 62-202 relating to Take-Over Bids - Defensive Tactics[35] (Notice 62-202). The Notice and the much of the regulation governing takeover bids reflect the logic developed in the *Report of the Attorney General's Committee on Securities Legislation in Ontario*[36] (the Kimber Report) published in 1965.

Essentially, Notice 62-202 indicates that the CSA will intervene by issuing a cease trade order when a shareholder rights plans or another defensive measure would hamper the takeover bid or prevent securityholders from responding to it.[37]

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33 *Id*., page 36.

34 *Id*.

35 Bulletin de l'Autorité des marchés financiers, 2003-07-18, Vol. XXXIV No. 28; or, elsewhere in Canada, Instruction générale 62-202, *Les mesures de défense contre une offre publique d'achat*.

36 Province of Ontario, *Report of the Attorney General's Committee on Securities Legislation in Ontario*, March 1965.

37 Notice 62-202, s. 1.1, paragraph 5.

Accordingly, a shareholder rights plan that has been implemented may only be a temporary measures and must eventually be withdrawn. However, it is acknowledged that the shareholder rights plans can foster additional competing solicited or unsolicited bids by the board of directors. With this in mind, the time limit usually granted by the CSA for the maintenance of the plan ranges from 45 to 55 days from the launching of the takeover bid.[38]

It is the Task Force's understanding that current securities regulations restrict the leeway of the boards of directors of corporations targeted by a hostile takeover bid.[39] This restriction does not exist in the United States, where shareholder rights plans may be permanent. While it is generally acknowledged that the boards of directors are in the best position to evaluate takeover bids according to the corporation's long-term interests, regulations in Canada allow securities authorities to terminate, in the name of the public interest, shareholder rights plans or other takeover defence tactics, thereby interfering in the internal governance of the companies and making them more vulnerable.

FIDUCIARY DUTIES OF THE DIRECTORS

When the relevance for a board of directors to adopt safeguards against a takeover bid is evaluated, it is essential to examine the true role of the directors under the circumstances. This section briefly takes stock of the most recent developments concerning the directors' fiduciary duty, which establishes the general objective that must guide the directors in decision-making.[40]

In Québec, section 119 of the QBCA stipulates that "in the exercise of their functions, the directors **are duty-bound toward the corporation** to act with prudence and diligence, honesty and loyalty and **in the interest of the corporation.**" [OUR EMPHASIS]

In the case of federally incorporated companies, the first paragraph of section 122 of the *Canada Business Corporations Act* stipulates that "[e]very director and officer of a corporation in exercising their powers and discharging their duties shall (a) **act** honestly and in good faith **with a view to the best interests of the corporation**; and (b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances." [OUR EMPHASIS]

Since there is some similarity between the two provisions, Canadian judicial decisions can have an influence on the interpretation that might be made of section 119 of the QBCA, which came into force in 2011.[41]

38 Notice and Request for Comment of the CSA, Draft Regulation 62-105 respecting Security Holder Rights Plans and Draft Policy Statement to Regulation 62-105 respecting Security Holder Rights Plans and draft consequential amendments, March 14, 2013, page 7.

39 For a description of the regulations governing takeover bids and their interpretation and a brief overview of the most important decisions concerning shareholder rights plans, please consult: Autorité des marchés financiers, *Document de consultation, Un regard différent sur l'intervention des autorités en valeurs mobilières dans les mesures de défense*, March 14, 2013, pages 5 to 11.

40 Raymonde Crête and Stéphane Rousseau, *op. cit*., page 392.

41 To date, no judgment has truly clarified the interpretation that may be made of the notion of the directors' fiduciary duty in the context of the application of section 119 of the QBCA. It will, therefore, be useful to monitor new developments in this respect.

The law courts have on several occasions examined the duties of directors. The most important recent judgments are undoubtedly those handed down by the Supreme Court of Canada in *Peoples Department Stores Inc. (Trustee of)* v. *Wise*, [2004] 3 S.C.R. 461 et *BCE inc*. et *BCE Inc.* v. *1976 Debentureholders*, [2008] 3 S.C.R. 560. The two judgments have certainly "upset considerable conventional wisdom in the realm of corporate law, in particular as regards the duties of caution, diligence and loyalty"[42] [TRANSLATION] of directors and senior executives.

We must be cautious when reading the judgments from the standpoint of Québec legislation, which was adopted subsequently. While the Supreme Court of Canada has examined the text of the federal legislation with respect to the directors' fiduciary duty, Québec legislators sought to specify that such duty was due solely to the corporation and not toward certain categories of shareholders,[43] nor toward other stakeholders. To this end, attorney Paul Martel notes that "the purpose of the amendment of section 119 of the QBCA is to stipulate that, contrary to what the Supreme Court of Canada asserted in the *Peoples* and *BCE* judgments, the directors' duty of caution and diligence, just like their duties of honesty and loyalty, are aimed at the corporation and not at any individual in general."[44] [TRANSLATION]

Despite this clarification, fiduciary duties under Québec and Canadian law are not very different inasmuch as the corporation's interest includes, in particular, its long-term survival. At the time of a hostile takeover, in particular, it is often the corporation's long-term survival that is the focal point of debate. In such instances, it seems clear that the interest of several stakeholders can certainly merge with that of the corporation.

In the two judgements mentioned earlier, the Supreme Court of Canada abandoned the traditional approach centred on shareholder primacy. Fiduciary duty is not confined to the value of shares or short-term profit. It also covers the corporation's long-term interests. Accordingly, the directors **may**, when making a decision in the interest of the corporation, take into account the interests of stakeholders other than the shareholders. According to the *BCE* judgement, the choice of the stakeholders to be favoured is then a decision protected by the principle of judicial deference, i.e. the business judgment rule.[45]

According to the definition of the business judgment rule stated in the *Peoples* judgment, "The court looks to see that the directors made a reasonable decision not a perfect decision. Provided the decision taken is within a range of reasonableness, the court ought not to substitute its opinion for that of the board even though subsequent events may have cast doubt on the board's determination[46]". "Since the *BCE* judgment, judicial deference also protects the

[42] Raymonde Crête and Stéphane Rousseau, *op. cit*., page 392.

[43] Paul Martel, *Les sociétés par actions au Québec, Volume 1 : Les aspects juridiques*, Éditions Wilson & Lafleur, Martel ltée, updated March 2012, paragraphs 23-203 and 23-204.

[44] Paul Martel, *Loi sur les sociétés par actions* (Québec) (RLRQ, chapitre S-31.1), *Réforme en profondeur de la Loi sur les compagnies*, Loi et commentaires, Blakes, 2011, page 60.

[45] Paul Martel, *Mesures anti-prises de contrôle*, study commissioned by the Ministère des Finances et de l'Économie, January 9, 2013, page 16.

[46] *Maple Leaf Foods Inc*. v. *Schneider Corp*. (1998), 42 O.R. (3d) 177, page 192, judgment cited in *Peoples Department Stores Inc. (Trustee of)* v. *Wise*, [2004] 3 S.C.R. 461, page 492.

directors against challenges in which it is maintained that they did not make a decision in the interest of the corporation."[47] [TRANSLATION]

Despite the Supreme Court of Canada judgments, it should be noted that securities regulations, in particular under Notice 62-202, are based primarily on the principle of shareholder primacy and that intervention by securities regulators pursuant to the Notice appears to run counter to the principles of corporate law whereby the directors must act in the best interests of the corporation pursuant to their fiduciary duties.

Moreover, it appears that as regards the evaluation of the business decisions of board of directors, securities regulators do not allow boards of directors to fully play their role and act in a way that ensures the long-term survival of businesses, which clearly runs counter to the principles of deference recognized by the courts. In this respect, current regulations make Canadian and Québec corporations especially vulnerable to hostile takeover bids.

The Task Force therefore believes that it is necessary to revise the applicable regulations pertaining to defensive tactics against hostile takeover bids. Even if the amendments to Québec legislation initially had only a limited impact on businesses incorporated under the legislation, it is not inconceivable that the introduction of the possibility of benefiting from adequate means of defence may interest a number of major entrepreneurs, who might take advantage of this opening to continue under Québec legislation.

THE CSA'S PROPOSAL

To codify and harmonize the current stance of the CSA with respect to shareholder rights plans, the CSA is proposing to make certain amendments to the applicable regulations by reviewing the treatment of shareholder rights plans in all of the territories that the CSA represents.

"The Proposed Materials establish a regulatory framework for Rights Plans in all CSA jurisdictions. In general, the Draft Regulation will allow Rights Plans adopted by boards of directors of issuers to remain in place provided majority security holder approval of the Rights Plan is obtained within specified times [the proposed specified time would be 90 days after the date of adoption of the shareholder rights plans or, if it is adopted after the launching of the takeover bid, within 90 days of the date of launching]. This approach would change the current regulatory treatment of Rights Plans." Accordingly, "securities regulators do not anticipate intervening on public interest grounds to cease trade a Rights Plan that was adopted in compliance with the Draft Regulation unless the target issuer engages in conduct that undermines the principles underlying the Draft Regulation or there is a public interest rationale for the intervention not contemplated by the Draft Regulation. Therefore, if the Draft Regulation was in force, the principle that "there

[47] Raymonde Crête and Stéphane Rousseau, *op. cit*., p. 475; *BCE Inc. v. 1976 Debentureholders,* 2008 CSC 69, paragraph 40. See also Patrick Desalliers, *Responsabilité des administrateurs en vertu du droit commun,* dans Juris-Classeur Québec, coll. "Droit des affaires," Stéphane Rousseau (Director), *Droit des sociétés*, Montréal, LexisNexis, 2009, page 26.

comes a time when the pill has got to go" would generally be no longer applicable to the review of Rights Plans by securities regulators."[48]

The implementation of the proposed amendments will require, in particular, changes to Notice 62-202 in order to withdraw shareholder rights plans from its application.[49]

Theoretically, the proposed amendment would "allow a board to maintain a Rights Plan in place for an indefinite period of time and in the face of a hostile take-over bid if the Rights Plan is approved by target company shareholders and the Rights Plan complies with the terms of the Draft Regulation. Nonetheless, the Draft Regulation preserves the ability of a hostile bidder to make an offer directly to target shareholders and, if there is a Rights Plan in place, to seek shareholder support for the termination of the Rights Plan. In this way, the Draft Regulation will still facilitate direct challenges to Rights Plans without obliging a bidder or aggrieved shareholder to launch a proxy contest for the purpose of installing a board that will support removal of the Rights Plan."[50]

In practice, the impact of the proposed measures would only be to prolong the time limit, now ranging from 45 to 55 days,[51] before securities commissions issue a cease trade order that terminates the shareholder rights plans.

Given that, in the Canadian context, corporations that are "put into play" after an initial takeover bid frequently end up being sold despite reliance on shareholder rights plans, the extension of the time limit of this temporary measure should in no way alter the final outcome of the sale of the corporation. It should also be noted that a significant proportion if not most of the shares of the corporation targeted by a takeover bid will, at the time of a possible vote by the shareholders, be held by arbitrage funds, which, as we have seen, are interested solely in the quickest conclusion of the transaction announced.

THE AUTORITÉ'S PROPOSAL

The Autorité's proposal is twofold. First, it seeks to redefine the intervention of the CSA in takeover defences. To this end, a new opinion would replace Notice 62-202 and would clearly indicate (i) that takeover defences are not prejudicial to the public interest and (ii) that securities regulators would refuse to issue cease trade orders on securities in their regard unless it appears that the board of directors of the target corporation has not adequately managed conflicts of interest or that the takeover defence adopted results in a clear violation of the securityholders' rights or undermines the smooth operation of the markets.

Second, it seeks to "change our take-over bid regime to require, as an irrevocable condition of any bid for all securities of a class, and for any partial bids, that more than 50% of the outstanding securities of the class held by persons other than the offeror and those acting in concert with it be tendered and not withdrawn on the date the bid would otherwise expire. We would also propose that the bid be

48 Notice of consultation of the Canadian Securities Administrators, *op. cit*., pages 1-2.

49 *Id*.

50 *Id*., page 13.

51 *Id*., page 7.

extended for 10 days following the announcement that this percentage of securities has been tendered."[52]

As for the first element targeted, the Autorité's proposal specifies that:

> We are also of the view that it would be appropriate to consider, among other things, certain facts in assessing the reasonableness of the target corporation board's actions in proposing or implementing a defensive measure, for instance:
>
> — the establishment of a special committee of independent directors with the mandate to consider and review the bid and make a recommendation to the board;
>
> — the appointment of independent financial and legal advisers to assist the special committee in fulfilling its mandate;
>
> — the conclusion of the special committee and the board that, based on their review of the bid and on the advice of legal and financial advisers, it is in the best interests of the corporation to implement a defensive measure;
>
> — the completeness of the disclosure provided to security holders in the directors' circular, and any other form of communication used by target directors, on the process followed to provide their recommendation and their reasons in support of the defensive measure.
>
> The guidance to be proposed would complement the appropriate degree of competence and skill, including careful and informed deliberation that directors are expected to demonstrate as part of their duty of care.[53]

The first component of the Autorité's proposal thus consists in changing the premise whereby the maintenance of takeover defence tactics is necessarily contrary to the public interest and, consequently, to redefine its intervention based on the public interest. The proposal is intended to allow a board of directors to determine what is in the best interests of a targeted corporation in the exercising of its fiduciary duties, without the intervention of securities regulatory authorities. For example, in certain cases, a board of directors could determine that the sale of the corporation at the highest price possible is in the best interests of the corporation and its shareholders. In other cases, the board of directors might determine that the sale is not in the corporation's best interests or at least that it is not the best price offered and, in this instance, it is essential that the board of directors, when exercising its fiduciary duties, implement the measures that it deems appropriate under the circumstances.

In this proposal, the Autorité provides only a few examples of safeguards that make it possible to judge whether "the approach adopted by the board of directors of a targeted corporation to propose or implement a takeover defence is reasonable." [TRANSLATION] However, it must be understood in the Autorité's proposal that securities regulators should be called upon to intervene much less frequently in respect of takeover defences adopted in response to hostile takeover bids by the board of directors of an offeree. It might be more incumbent upon the courts, through recourse in common law, to determine whether the decisions of the board

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52 Autorité des marchés financiers, Consultation Paper, *An Alternative Approach to Securities Regulators' Intervention in Defensive Tactics*, March 14, 2013, page 2.

53 *Id*., page 15.

of directors in this context conform to its fiduciary duties. The courts, in the wake of the Supreme Court of Canada judgment in BCE could then be expected to examine the question in light of the business judgment rule.[54]

The second component covered by the Autorité's proposal is intended, in particular, to eliminate current uncertainty stemming from the bidding process that the shareholders face. Comments made during the consultation reveal that the vast majority of the commentators were very favourable to the measures.

Of the two components targeted in the Autorité's proposal, the changes suggested could lead to legislative or regulatory amendments pertaining to takeover bids.

The Task Force noted that the Autorité's proposal received significant support from many Québec firms listed on the stock exchange, several directors' groups and business groups, and institutional investors. The Task Force supports the proposal of the Autorité aimed at allowing the boards of directors of corporations subject to a hostile takeover bid to fully exercise their fiduciary duties. It also believes that the proposal, insofar as it applies to all corporations listed on the stock exchange that are reporting issuers in Canada, is likely to restore balance between the offeror of an unsolicited takeover bid and the offeree. The Task Force is of the opinion that the Autorité's proposal can contribute in a valid manner to making Québec corporations less vulnerable to hostile takeover bids, while the CSA project is clearly insufficient in this regard.

IMPACT OF ANTI-TAKEOVER MEASURES

Before it submitted recommendations on the desirable safeguards, the Task Force examined the possible economic impact of protective measures. It asked Professor Jean-Marc Suret, PhD, Fellow CIRANO and a lecturer in the Faculté des sciences de l'administration, Université Laval, to draft a summary report[55] on studies devoted to the question.

Specialists have always vigorously debated the real or anticipated impact of protective measures adopted by corporations against unwanted takeover bids on the value of the shares of corporations. A number of specialists maintain that the discipline imposed by the financial market provides a stimulus for the corporation to maximize its financial performance, that the possibility of receiving an unwanted takeover bid makes the corporation and its senior executives more vigilant regarding the corporation's performance, and that to the contrary any measure aimed at making it less likely or indeed impossible, such a takeover bid might make the senior executives more tolerant of the mediocrity of their results.

Other researchers take the opposite stance by concluding that excessive vulnerability to investors seeking short-term profit, first and foremost, encourages the senior executives to concentrate on short-term results at the expense of initiatives that can reduce immediate results, such as investments in research, but whose long-term impact would be more beneficial.

54 See the section "Fiduciary duties of the directors" and Paul Martel, *Mesures anti-prises de contrôle*, study commissioned by the Ministère des Finances et de l'Économie, January 9, 2013.

55 Jean-Marc Suret, *Les effets des mesures de protection contre les prises de contrôle*, report prepared for the Ministère des Finances et de l'Économie, January 17, 2014.

Extensive, diverse empirical research of varying accuracy has been conducted on this question at different periods, in different countries, within judicial frameworks that vary from place to place. The findings are equally varied: some researchers conclude that safeguards put corporations at a disadvantage while others conclude the opposite.

Overall, Professor Suret’s report concludes that protective measures adversely affect share value. However, it is true that certain sub-groups of businesses with specific characteristics appear to benefit from the addition of protective measures, for example when they previously had none. It is also understood that the impact of measures on share value is not a constant and can vary according to the time elapsed, acquisition activity and levels of concentration of sectors.

The Task Force believes that these conclusions must be considered with qualification. Indeed, several studies show that the presence of measures that make hostile takeovers more difficult eventually led to transactions concluded at higher prices. At the international level, serious studies also reveal that the value of corporations with controlling shares varies according to the legal oversight applicable to such shares and the quality of governance mechanisms, which is the case in Canada, where such oversight is extensive.

What is more, the possible impact must be considered in parallel with the significant adverse effects that the loss of head offices from Québec can engender. The Task Force is emphasizing an approach that makes it possible to give protective tools to corporations that wish to benefit from them rather than a protective measure that would apply systematically to all Québec corporations.

SAFEGUARDS AGAINST HOSTILE TAKEOVER BIDS

This section of the report describes the key safeguards and measures to develop and retain head offices that the Task Force considered before formulating its recommendations.

Several of the protective measures mentioned here are similar to those adopted in the United States and Europe. The Task Force has relied mainly on research conducted on behalf of the Ministère des Finances et de l'Économie by attorney Paul Martel, Ad. E., a special advisor in the legal affairs division at Blake, Cassels & Graydon LLP.

INCLUDE IN THE QBCA PROVISIONS THAT PREVENT A HOSTILE BIDDER FROM ENGAGING IN A NUMBER OF OPERATIONS WITH THE TARGET COMPANY (BUSINESS COMBINATION STATUTES)

This measure seeks to make less attractive acquisition without the consent of the board of directors by preventing the buyer from carrying out short-term transactions that enable it to finance the acquisition by means of the assets of the offeree.[56] According to the model found in many American states, as soon as a takeover bid is deemed hostile, the offeree may not merge, sell its assets, issue and transfer shares, liquidate, reclassify property and engage in any other similar transaction for the benefit of the purchasing corporation during a period ranging from two to five years following the date of acquisition of the shares.

This measure, like most of the other safeguards contemplated, may or may not be accompanied by an opting out right that is included in advance in the articles of incorporation of companies. A corporation that exercises an opting out right thereby remains vulnerable to unsolicited takeover bids. However, a number of American states have established certain restrictions to opting out, for example with super-majority votes or variable time limits before the coming into force of the opting out, or both.[57] Likewise, it would be possible to include safeguards in the legislation without making them automatically applicable to the corporations targeted and enable the latter to adopt the new provisions through an opting in voted by the requisite majority for this type of change.

This is an essentially dissuasive measure for buyers that wish to launch a takeover bid without first obtaining the support of the board of directors. Even if the constraints that it imposes on the offeree may seem very significant, the veritable objective of the takeover defence is to avoid the application of restrictions through the encouragement of balanced negotiations between the board of directors of the offeree and the potential buyer.

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56 Paul Martel, *Mesures anti-prises de contrôle*, study commissioned by the Ministère des Finances et de l'Économie, January 9, 2013, page 4.

57 *Id*., pages 4-5.

INCLUDE IN THE QBCA CONTROL SHARE ACQUISITION STATUTES

Control share acquisition statutes, which are popular in the United States, consist in withdrawing voting rights from the shares held by the offeror of a takeover bid and persons related to the bidder. The restriction on voting rights then applies until the other shareholders, excluding the directors and director-shareholders, adopt a resolution, usually with a two-thirds majority, restoring the voting rights to the potential buyer and the related persons.[58]

The measure certainly acts as a deterrent to hostile takeover bids. According to Paul Martel:

> if after the takeover the offeror does not obtain a favourable vote from the shareholders who did not accept the bid, the offeror risks not being able to vote the shares acquired and, as the case may be, to have the target company or a purchaser that has the consent of the board of directors buy back the shares. It is therefore in the offeror's interests to request a meeting before launching a bid to purchase shares, since at that point the shareholders who vote will include those likely to accept the offer. If they are fully informed of the offeror's intentions with respect to the corporation, they can knowingly grant the offeror the requisite majority. This allows the corporation more time to negotiate with the offeror or to seek a better bid.[59] [TRANSLATION]

INCLUDE IN THE QBCA PROVISIONS THAT AUTOMATICALLY ADJUST VOTING RIGHTS ACCORDING THE CHARACTERISTICS OF THE SHAREHOLDERS (VARIABLE VOTING SHARES)

This measure makes it possible to adjust the value of voting rights linked to shares according to the characteristics specific to different holders or the time limit for holding the shares, or both. For example, it should be mentioned that in France, it is possible to "confer by the articles of incorporation or a special shareholders meeting, a vote that is double that conferred on the other shares, on shares registered in the name of the same shareholder for at least two years. Such voting rights may be reserved for shareholders of French nationality or nations of a member State of the European Community (or a State covered by the agreement on the European Economic Area). A takeover bid does not cancel out the doubled voting right."[60] [TRANSLATION]

If the nationalistic aspect of the measure is undoubtedly not applicable in the Canadian context because of the numerous free trade agreements to which Canada adheres, the provision on variable or adjustable voting shares is a potential avenue to provide a partial safeguard, and as a means of ensuring that control of the company remains in the hands of long-term shareholders.

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58 *Id*., page 2.

59 *Id*., page 4.

60 Paul Martel, *Mesures anti-OPA en Europe*, study commissioned by the Ministère des Finances et de l'Économie, August 1, 2013, page 16.

This protective measure hinges on the premise that the shareholder-investors who have a short-term perspective tend to opt systematically for a takeover bid since it allows them to maximize their returns in the short term. Shareholders who have held shares for a longer period will, potentially, tend to consider the corporation's long-term business plan. With enhanced voting rights, they can, in particular, more readily choose to support the position of a board of directors opposed to a takeover bid.

This type of measure would make it hard for potential buyers to launch an unsolicited takeover bid without, however, entirely preventing them from doing so.

As is true of the business combination statutes, consideration could be given to accompanying the measures with opting out or opting in with or without a time limit.

REVISE THE QBCA CONCERNING THE ELECTION OF A CLASSIFIED BOARD OR STAGGERED BOARD

Typically, "in a staggered board, the directors are grouped together by classes (usually three) whose members are subject to election at successive annual meetings. With three classes, the directors in each group are thus elected for a three-year term. Only one class may be elected at each annual meeting. To take control of a staggered board comprising three classes, a hostile offeror must win two proxy solicitation battles at two consecutive annual meetings. Given the time limit that this implies, the presence of a staggered board may discourage a takeover attempt."[61] [TRANSLATION] To be more effective, this measure may also be accompanied by a prohibition of removing the members of the board of directors before the expiry of their term, except for certain specified causes.[62]

"In Québec, the *Business Corporations Act* already makes provision for staggered terms (s. 110). It would suffice to add the clause prohibiting among the reporting issuers the removal of the directors of the reporting issuers whose terms are staggered other than for cause."[63] [TRANSLATION]

This measure would run counter to the requirements of the Toronto Stock Exchange. Indeed, the TSX has just amended its *Company Manual*[64] to compel corporations listed on the exchange to elect all of their directors every year (s. 461.1, which came into force on December 31, 2012), thereby excluding the possibility of staggered terms.[65] However, a company could introduce this measure into its articles of incorporation if it elected to be listed on the stock exchange only in the United States.

61 Stéphane Rousseau and Patrick Desalliers, *op. cit*., page 33.

62 Paul Martel, *Mesures anti-prises de contrôle*, study commissioned by the Ministère des Finances et de l'Économie, January 9, 2013, page 19.

63 *Id*.

64 TMX, *TSX Company Manual*, tmx.complinet.com/en/tsx_manual.html, consulted on February 10, 2014.

65 *Id*., section 461.1.

APPLY THE PRINCIPLE OF RECIPROCITY RESPECTING EXISTING CORPORATE DEFENCE RULES AT THE PLACE OF INCORPORATION OF THE CORPORATION THAT LAUNCHES A HOSTILE TAKEOVER BID

The safeguards, which draw inspiration from the European model, are of two kinds.

1. When a corporation that launches a hostile takeover bid has the possibility of being protected under the rules applicable at its place of incorporation, the Québec offeree might have recourse to the same safeguards, if necessary.

2. When a corporation that launches a hostile takeover bid has the possibility of being protected under the rules applicable at its place of incorporation, the Québec offeree might have recourse to the safeguards predefined in the QBCA and available solely in the case of hostile takeover bids that satisfy certain criteria.

The objective of these measures is to avoid situations such as that of Alcoa-Alcan, i.e. to level the rules and prevent a one-way application of the *Pac-Man* defence.[66]

The Task Force believes that it would be difficult to apply this kind of measure given the costly debate that might occur to define what does or does not constitute a means of defence pursuant to legislation in foreign States.

DEFINE THE RULES GOVERNING RELIANCE OF SHAREHOLDER RIGHTS PLANS (POISON PILLS)

The Canadian rules governing reliance on shareholder rights plans should be substantially revised. They are no longer warranted, in light of the recent judgments of the Supreme Court of Canada and make Canadian public corporations much more vulnerable to unwanted takeover bids in relation to American corporations.

The Task Force has examined the regulatory initiative pertaining to takeover defence tactics in the event of unsolicited takeover bids published by the CSA and the Autorité's proposal in this respect. As noted in the section entitled "The Autorité's proposal," the Task Force supports the proposal of the Autorité aimed at allowing the boards of directors of corporations subject to a hostile takeover bid to fully exercise their fiduciary duties. It also believes that the proposal, insofar as it applies to all corporations listed on the stock exchange that are reporting issuers in Canada, is likely to restore balance between the offeror of an unsolicited takeover bid and the offeree. The Task Force is of the opinion that the Autorité's proposal

66 Stéphane Rousseau and Patrick Desalliers, *op. cit.*, page 44: "In the context of the *Pac-Man* defence, the offeree responded to the takeover bid by attempting to buy the offeror. By thereby reversing the roles, the target sought to dissuade the offeror from proceeding with the transaction. Moreover, in its counter-offer, it recognizes implicitly the advisability of forming a group with the corporation that initially launched the takeover bid. However, with the counter-offer, the target seeks to dictate the conditions of the grouping instead of having them imposed on it." [TRANSLATION]

can contribute in a valid manner to making Québec corporations less vulnerable to hostile takeover bids, while the CSA project is clearly insufficient in this regard.

In this perspective, the Task Force recommends that the Minister of Finance and the Economy determine whether legislative or regulatory amendments might facilitate the implementation of the Autorité's proposal.

REPLACEMENT OF THE BUREAU DE DÉCISION ET DE RÉVISION (BDR) BY A SPECIALIZED SECURITIES TRIBUNAL

The government might contemplate the replacement of the BDR by an administrative tribunal specializing in securities whose members would be judges. The judges sitting on the tribunal could be chosen from among the judges from the commercial chamber of the Court of Québec, who would be seconded or released from their positions.

The establishment of a specialized administrative tribunal with access to a broader pool of jurists recognized for their expertise in the realm of securities could enhance the perception of quality of the decisions handed down by Québec judicial bodies in this regard. Québec would follow the example of Delaware, which maintains courts specializing in corporate law, recognized for the quality and consistency of their judgments, which would heighten the interest of firms in incorporating or continuing pursuant to Québec legislation.

The Task Force believes that it would be judicious to restructure the BDR based on the Professions Tribunal, which comprises judges from the Court of Québec.[67]

[67] *Professional Code* (CQLR, chapter C-26), s. 162: "A Professions Tribunal is established, composed of eleven judges of the Court of Québec designated by the chief judge of such Court who shall designate among them a chair and a vice-chair to replace him if he is absent or unable to act."

FISCAL MEASURES THAT CAN HELP TO MAINTAIN OR ATTRACT HEAD OFFICES IN QUÉBEC

To promote the maintenance of head offices established in Québec, encourage their development and even attract new ones, it is important that the Québec taxation system maintain or even enhance its competitiveness. Tax competitiveness must be apparent in the tax treatment of businesses, of course, but also with respect to the taxation of shareholders and senior executives. Québec fiscal policy should, therefore, be oriented in this direction.

EMPLOYEE SHARE PURCHASE PLANS

The first measure is to encourage employees to buy their company's shares. Several corporations offer not only this possibility but match their employees' share purchases with varying numbers of free shares.

This practice has numerous advantages. Aside from a greater feeling of belonging that it helps to instil and the financial return that it provides for the employees, the blocks of shares held by the employees and founders of certain corporations have been sufficiently big to make unlikely any unwanted takeover bid.

The Task Force is of the opinion that this practice should be encouraged by reducing the taxation of employees on the corporation's shares that they receive from their employer while maintaining the benefit that the employer derives.

THE TAXATION OF SENIOR EXECUTIVES

The second avenue consists in eliminating or reversing the considerable gap that has existed for several years in Québec between the tax treatment of gains obtained through stock options.

Since 2004, the gains realized by holders of stock options received in the workplace have been taxed at a level 50% higher than elsewhere in Canada. It should be noted that remuneration of the senior executives usually comprises a portion whose value varies according to the company's performance, which may reach up to 80% of total compensation. A large proportion of this variable pay comprises vehicles that refer to the value of the shares, including stock options. Such vehicles tend to crystalize at a fixed point in time after a certain number of years. The difference in the tax payable by an executive living in Québec in relation to elsewhere in Canada may reach millions of dollars for a given individual.

This possibility considerably increases the level of difficulty in attracting senior executives to Québec or in preventing those living here from planning where to live when the time comes to exercise their stock options.

In fact, this situation produces an outcome contrary to what taxation authorities expect, since neither the amount of the additional tax, the basic amount nor the tax on the rest of the individual's income is collected.

Were Québec to offer more advantageous tax treatment than elsewhere, the opposite effect would occur and more revenue would be collected.

THE LONG-TERM SURVIVAL OF QUÉBEC CORPORATIONS

The third avenue in the realm of taxation consists in re-examining the taxation of capital gains at the time of death of an owner or a key shareholder-founder of a business.

Since the tax on capital gains is payable whether or not the company's shares are sold, the estate is often obliged to sell control of the firm in order to pay the taxes. This can obviously call into question the head office's long-term survival. There are several ways to overcome this situation, including the purchase of life insurance policies or the establishment of family trusts. Aside from the their costs, such measures are not permanent since the trusts have a duration limited to 21 years, after which the assets of the trusts again become taxable.

The Task Force believes that it would be possible to seek guidance in what is allowed in the case of an agricultural enterprise and allow the deferral of the capital gain until the shares are sold, which might allow the estate to maintain control over the company and, in so doing, maintain the head office.

TASK FORCE ON THE PROTECTION OF QUÉBEC BUSINESSES

In the wake of its consultations, the studies conducted for the purposes of drafting this report and its review of the analyses carried out on the topic, the Task Force on the Protection of Québec Businesses has adopted several guiding principles that have shaped its recommendations to the Minister of Finance and the Economy.

THE IMPORTANCE OF HEAD OFFICES

The economic and social importance of head offices located in Québec is considerable. The head offices provide numerous high quality, well-paid jobs. Aside from the jobs linked directly to the head offices, mention must also be made of the jobs provided by many suppliers, in particular specialized professional firms that operate in the environment of the head offices. This cluster of specialized firms makes the cities that host head offices more attractive for other economic operations. Conversely, the disappearance of a head office engenders more than the loss of direct jobs. It also reduces local demand for professional services, accommodation and air transport, thereby limiting the drawing power of the city affected by the loss.

We must, therefore, focus not only on the preservation of head offices but also on their growth and development. The head offices of thriving firms that are developing the world over are central to big cities like Montréal. It is not merely a question of protecting them: we must establish conditions to foster their development, thereby enhancing their economic and social impact in Québec as a whole.

THE VULNERABILITY OF HEAD OFFICES

The Task Force's deliberations have confirmed the vulnerability of corporations listed on the stock exchange to unwanted takeover bids. This observation is not confined to corporations located in Québec. The same situation prevails everywhere in Canada, since legislation governing corporations is fairly similar and securities regulations are harmonized throughout the country.

The Task Force has also noted that financial markets have evolved considerably over the past 20 years. Institutional investors, which dominate the market, are negotiating with growing frequency on stock exchanges the shares of businesses that they possess. A new generation of "alternative" investors, which are managing considerable funds, has developed mathematical-sciences-based investment strategies instead of relying on an understanding of business issues, often applying them aggressively. What was previously regarded as an investment in the basic qualities of a company often becomes an "ingredient" in a scaffolding of so-called "structured" products. Financial markets have thus become more complex, motivation is more diversified and often short-term, which subjects public corporations to even more numerous constraints.

The Task Force has, therefore, concluded that these developments warrant offering businesses additional means to manage situations in which unwanted takeover bids are launched. What is more, it is remarkable that a significant number of big Québec corporations share a common trait, i.e. the presence of multiple voting shares, which enables the founders to exercise full control over such situations. While in recent years the financial markets and governance gurus perceived multiple voting shares in a negative manner, they are an important tool to maintain the long-term survival of businesses. However, this negative perception has encouraged several Québec corporations to restrict the useful life of such shares or to abandon them. A number of recent initial public offerings have nonetheless been made both in Canada and in the United States with a class of multiple voting shares, in particular by Google, Facebook, Bombardier Recreational Products and Manac.

THE IMPORTANCE OF AVOIDING THE DEVALUATION OF CORPORATIONS

The Task Force is aware that an overly protective legislative approach can at one and the same time foster complacency in public corporations with respect to their performance and disinterest on the part of financial markets, which might perceive a source of more limited value creation and thereby ascribe less value to Québec corporations. Such a consequence would considerably hamper such corporations' development and prosperity.

The Task Force believes that the measures that it is recommending will not go against the recognition of the full value of Québec public corporations by the financial markets since the corporations may decide whether or not to take advantage of them.

MAKE QUÉBEC MORE COMPETITIVE

While there is concern that corporate takeovers can lead to the disappearance of head offices, Québec must also ensure that existing head offices are encouraged to develop. A head office usually assembles the company's senior executives, who are the highest paid and typically, most of whose compensation comes from compensation plans that vary according to the company's performance over several years. It is, therefore, important that the Québec taxation system be highly competitive with those of neighbouring taxation authorities if we wish to attract to Québec and retain senior executives. Fiscal policies must be competitive, which they have not been for nearly 10 years.

ENHANCE THE LONG-TERM SURVIVAL OF QUÉBEC CORPORATIONS

One factor that is less well known and, above all, less spectacular than a hostile takeover bid can also lead to the sale of a company and trigger the closing of a head office, i.e. the taxation of capital gains that applies at the time of death of a company founder.

This system is not unique to Québec since it applies throughout Canada, except in the context of an agricultural enterprise, which can be transferred tax-free from one generation to the next.

The Task Force believes that Québec could follow the example of several European countries where the transmission of the ownership of shares in a company from one generation to the next is tax-free as long as ownership is maintained and the business remains active.

In Québec as elsewhere in Canada, at the time of death of the founders or key shareholders, a “deemed disposition” of the company shares that they possess occurs. The deemed disposition, whether or not the shares are sold, leads to the taxation of the capital gain on the value of the shares accumulated for an entire lifetime, which can be considerable. In some instances, this tax requirement leads to the sale of the enterprise to enable the estate to pay the taxes that the death has triggered. In other instances, estate planning that is as complex as it is costly attempts to circumvent the triggering of tax payable to avoid forcing the sale of the business. However, it must be remembered that, over the years, the change in the taxation system has had for consequence that no such planning may indefinitely defer the deemed gain.

The Task Force is of the opinion that at a time when a number of major Québec businesses that have emerged from the revolution in the business world over the past 30 years are grappling with significant succession challenges, the Québec government should focus on measures to facilitate the transmission of businesses to future generations. This would make it possible to maintain greater numbers of head offices in Québec for a long time.

Another way to promote the long-term survival of companies is to facilitate the transmission of their ownership to other Québec investors. A number of public and private Québec investment funds have displayed interest in recent years in the transmission of the ownership of companies, either from one generation to the next or from a founder to his employers or from a founder to another group of owners from Québec. These cases are usually complex, require considerable patience and are scattered throughout Québec’s territory. The capital required for such transactions often exceeds by far the means of the interested Québec buyers, which requires financing packages that may exceed the investment constraints applicable to the funds that are interested in the transactions. Indeed, limits are often placed on the maximum equity interest that a fund may devote to a single investment. Several of the funds are unable to acquire most of the capital of a business, even temporarily, to facilitate the necessary financing package. Certain funds more extensively involved in the transmission of ownership might also benefit from additional capital to broaden their level of operations.

For this reason, the Task Force is of the opinion that the Minister of Finance and the Economy should examine the legislative or regulatory amendments that might facilitate the task of such investment funds in their mission to facilitate the transmission of the ownership of businesses in Québec.

BROADEN THE INTEREST OF CORPORATIONS TO INCORPORATE OR CONTINUE PURSUANT TO QUÉBEC LEGISLATION

Corporations currently based in Québec have the choice to incorporate pursuant to the *Canada Business Corporations Act* (CBCA) or the Québec *Business Corporations Act* (QBCA). The Task Force has not noted specific trends concerning the decision by corporations to incorporate or continue under either statute. It goes without saying that the Québec government may only amend the QBCA and that any changes thereto will only apply to corporations governed by Québec legislation, thereby limiting its scope.

In the United States, corporations may choose to incorporate pursuant to the legislation of the state of their choice. Accordingly, numerous corporations from all over the United States have incorporated and are continuing in Delaware. Observers generally note that Delaware's legislation offers considerable advantages and flexibility to corporations that incorporate there. But that is not all. Over the years, Delaware courts have acquired such expertise in the realm of corporate litigation handled there that many corporations now believe that it is the ideal place in which to incorporate. The rules are clear, the jurisprudence is extensive, and the judges in these fields are competent.

The Task Force believes that the QBCA could be made more attractive to businesses and that the bodies that hear the attendant litigation could be more widely recognized for their expertise. In so doing, the number of companies incorporated might increase, making the measures that the Task Force is proposing more universal and, consequently, more effective.

RECOMMENDATIONS

The Task Force therefore wishes to make to the Minister of Finance and the Economy the following recommendations concerning the protection of head offices in Québec.

RECOMMENDATIONS RESPECTING THE QUÉBEC *BUSINESS CORPORATIONS ACT*

1. Amend the Act to make possible the adoption of variable voting rights according to the length of time that the shares of corporations are held. The Task Force proposes the following implementation formula:

   — the voting shares of the corporation may include an additional voting right when the veritable owner has held such shares for two years or more.

     — The measure stipulated could be included in the articles of constitution of the corporation.

     — It might also be introduced into the corporation's articles of incorporation subsequent to its incorporation or be withdrawn at any time by special resolution of the shareholders, in which case the shareholders could exercise their usual rights.

2. Amend the Québec *Business Corporations Act* to allow for the adoption of provisions to prohibit certain transactions by corporations subject to a takeover bid not approved by the board of directors. The Task Force proposes the following implementation formula:

   — a merger or other amalgamation of the assets of the corporation with those of the offeror or a substantial sale of assets representing 15% of the corporation are prohibited for five years;

   — the offeror must give to the corporation the profits made in the 24 months following the takeover bid at the time of resale of the shares of the corporation purchased during the 12 months preceding the launching of the takeover bid;

   — the revocation of the term of office under way of a director (of a maximum duration of three years) may not occur before the end of his term;

   — the offeror may not exercise its voting right in respect of the shares that it holds after the launching of the takeover bid. This measure will apply until the other shareholders, excluding the directors and the manager-shareholders, adopt a resolution with two-thirds of the votes restoring the voting rights to the initiator of the takeover bid and persons related thereto;

     — the measures stipulated above could be included in the articles of constitution of the corporation;

— they might also be introduced into the corporation's articles of incorporation subsequent to its incorporation or be withdrawn at any time by special resolution of the shareholders, in which case the shareholders could exercise their usual rights.

3. Measures similar to those stipulated in recommendations 1 and 2 should be applicable to all entities incorporated in Québec likely to make a public issue and be subject to a hostile takeover bid. Accordingly, they should be applicable to issuing entities governed by the *Civil Code of Québec,* such as certain trusts.

RECOMMENDATIONS CONCERNING SECURITIES REGULATORS

4. The Task Force supports the proposal of the Autorité des marchés financiers to allow the board of directors of corporations that are subject to a hostile takeover bid to fully exercise their fiduciary duties and believes that the proposal, insofar as it is applied to all companies listed on the stock exchange that are reporting issuers in Canada could restore balance between the initiator of the unsolicited takeover bid and the offeree. In this perspective, the Task Force recommends that the Minister of Finance and the Economy determine whether legislative or regulatory amendments might facilitate such an implementation of the Autorité's proposal.

5. Convert the Bureau de décision et de révision into a specialized administrative tribunal comprising judges from the Court of Québec. The structure of the tribunal could draw inspiration from the Professions Tribunal.

THE DEVELOPMENT AND LONG-TERM SURVIVAL OF HEAD OFFICES

6. Make provision for more advantageous tax treatment that encourages the employees of corporations listed on the stock exchange to hold shares by deferring the taxation of the employees to the time of sale of the shares instead of the time of their acquisition.

7. Grant tax treatment of the gains on stock options that is more favourable than elsewhere in Canada to maximize the development of head offices and the attraction and retention of senior executives to Québec or at least harmonize such tax treatment with the other Canadian provinces.

8. Reassess the Québec taxation system to allow the owners and major shareholders of a company to defer the taxation of the gain on the transmission of ownership of a corporation to another generation and introduce a measure that allows family trusts to defer the realization of the gain attributable to their significant investment in a company at the time of its sale rather than every 21 years, as long as the business remains active.

9. Promote the financial and operational participation of Québec investment funds to facilitate the transmission of Québec corporations to a new generation of Québec owners and, consequently, examine the requisite legislative and regulatory amendments.

Québec