BANKING ON CORPORATE

BY NEILL MAY

What was the point of that again?

Corporate law is, I suppose, like a lot of specialized activities — users of corporate legal services seem generally to have little interest in, or understanding of, the ugly machinery of the industry (in this case, the vagaries of statutory requirements, the overlay of common law dictates, and the realities of common practice). And really, why should they? When someone comes to fix my hard drive, I don't want to know details about the processor, the circuitry, or the history of the PC. I just want to know that there are either no problems, or that whatever problems there were have been fixed.

This dynamic creates interesting results when the service provider, like most corporate lawyers, charges by the hour. Client confusion is natural and predictable when presented with a large invoice for a corporate lawyer having (a) identified a problem the client never imagined (much less knew it had) and (b) invested significant time in crafting a solution for that problem.

Many "technical issues" raised by corporate lawyers are matters where a legitimate interest is served. But the law does tend to accumulate, and some requirements outlast the mischief they were originally designed to address. A good way to identify this legal baggage is the classic test of going back to "first principles," to consider the original objective of the legal requirement. If a lawyer struggles to articulate the purpose of a given rule, that is a healthy clue that the requirement may have outlived its usefulness (I'm too polite to mention that it may also, however, be an indication that the question is being asked of the wrong lawyers). It is not difficult to understand how some of these things survive: it is much easier to leave the anachronisms alone, there is no easy way to calculate the societal costs of leaving them alone, and there are collective action problems in seeking to fix them. But there is a cost.

Three examples leap quickly to mind. The first is the "solvency test" that continues to apply under some provincial corporate statutes to dividends and other returns of capital. That requirement imported into corporate law an element of creditor protection that may have served a necessary purpose at inception. However, in a modern era, with evolutions in creditor protections and increased creditor awareness of their risks, the need for these provisions is debatable. More curious, the formula for assessing "solvency" under some corporate statutes continues to use the concept of "stated capital," an anachronism that oddly enough can be varied by the shareholders themselves (interesting from a creditor protection perspective). This type of seemingly benign requirement can result in much corporate, tax, and tactical structuring that has little or nothing to do with the original intent of the requirement.

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Another example is "corporate incest," which describes a phenomenon less sensational than its label. Statutory "corporate incest" provisions prohibit corporations from owning shares in themselves, or in their parent corporations. When adopted, these provisions were targeted at potential distortions in voting or financial reporting that might result from "incestuous" share ownership, but those concerns have either been superseded by developments in reporting or can be easily better addressed directly. The hangover of the "corporate incest" provisions, however, often results in transactions being contorted into knots. Thinking around that type of legal obstacle can be a challenging mental exercise, but the social benefits of the required expenditure of effort are not all that apparent (that is my lawyerly way of describing a complete waste of time).

One last example is the prohibition, subject to limited exceptions, on share transfer restrictions for publicly traded corporations in some corporate statutes. The provision was presumably implemented to facilitate trading in securities of those corporations. The requirement, however, is not necessary to achieve that objective today, and the nature of the limited exceptions makes clear that the rule was developed a long time before the legislators envisaged international securities offerings and the use of highly detailed regulatory restrictions to achieve all manner of governmental objectives. Bottom line, the lingering requirement is an unjustifiable impediment to transaction structuring.

One effect of these anachronisms is jurisdiction shopping. Though that too imposes costs, it is in some ways a healthy process in that it should result in re-examination of local legal requirements. However, though clients may not be interested in discussing the technicalities, corporate law, like every other area of law, must keep abreast of the reality it regulates. Continuous re-examination to ensure the law remains relevant is the least the public, the ultimate client, deserves (even if it doesn't understand the circuitry). And besides, I have enough trouble on most days explaining the stuff that actually makes sense. CL

Neill May is a partner at Goodmans LLP in Toronto. His practice focuses on all aspects of securities law, with an emphasis on M&A and corporate finance. E-mail him at nmay@goodmans.ca. *The opinions expressed are those of the author alone.*