Accountability of Corporate Management: Analysing the Fiduciary Duty in Corporate Law

by

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Abstract

Scholars have called for the federal government to enact legislation to restore directors' duties as owed to the corporation, considering only the interests of shareholders. This is known as the shareholder primacy model. This thesis counters such criticism and argues for the emergence of an interdisciplinary model, in which shareholder primacy is relegated in favour of team production theory. This thesis dispels the theory that the business judgment rule can protect directors who do not consider the interests of multiple stakeholders, which has been argued to be a shield to protect shareholder primacy in Canada. Shareholder primacy is no longer a feasible corporate governance model in the 21st century. The interest of the corporation must include not only shareholder wealth maximization, but also other interests involving the corporation's expanded liabilities under human rights laws, environmental laws, labour standards laws, and insolvency laws, thus benefiting multiple stakeholders of the corporation.

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Knowledge gives life to the soul.
-Ali Ibn Abi Talib (a.s)

Introduction

In a Canadian corporate governance context, and in accordance with Canadian federal and provincial regulations, every director and officer owes a fiduciary duty to their respective corporation,[1] that is, to act honestly and in good faith with a view to the best interests of the company.[2] Fiduciary duty in Canada is an equitable concept imported from England's Court of Equity.[3] At a minimum, fiduciary obligations can be explained as, "the relative legal positions [where] one party is at the mercy of the other's discretion."[4] However, corporate governance structure at large publicly traded corporations has been the subject of various debates; in particular, it is a debate centred on which stakeholder(s) should benefit from the meaning of "the best interests of the corporation."[5] No consensus has been reached on one vital defining question,

[1] Throughout the thesis I do not differentiate between board of directors and the management of the corporation. In my research I have seen a clear binary division between senior officers of a corporation, i.e., chief executive officers and the board of directors when discussing the compensation for the CEO or the CFO and other senior executives. However, because my research focuses on the fiduciary duty of the directors to the corporation, I see no reason to differentiate, and, thus, I interchangeably refer to the board of directors as directors, board of directors or the management of the corporation.

[2] Federally: *Canada Business Corporations Act,* RSC 1985, c. C.44 s 122(1): Every 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. Provincially: *Ontario Business Corporations Act*, RSO 1990, c B.16 s 134(1): Every director and officer of a corporation in exercising his or her powers and discharging his or her duties to the corporation shall, (a) act honestly and in good faith with a view to the best interests of the corporation. Other provinces have similar regulations. It is vital to note that throughout my thesis I focus on the statutory and common law fiduciary as per *CBCA* 122(1)(a) and *OBCA* (134)(1)(a). I do not intend to examine *CBCA* 122(1)(b) or *OBCA* (134)(1)(b). Both sections read: Exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. Care, diligence and skill are outside the scope of this thesis. I solely focus on the fiduciary duty - the statutory and common law fiduciary duty as owed by the director of the corporation to the best interest of the corporation.

[3] Otherwise known as Court of Chancery.

[4] Justice LaForest in *Lac Minerals Ltd. v. International Corona Resources Ltd.*, [1989] 2 SCR 574 cites Justice Dickson in the earlier case of *Guerin v. The Queen*, [1984] 2 SCR 335, 383-384: "The concept of fiduciary obligation originated long ago in the notion of breach of confidence, one of the original heads of jurisdiction in Chancery (equity). For further reading on the history and origin of fiduciary duty, please see Ernest J. Weinrib, "The Fiduciary Obligation" (1975) 25 UTLJ 1, 7."The hallmark of a fiduciary relation is that the relative legal positions are such that one party is at the mercy of the other's discretion…Where there is a fiduciary obligation there is a relation in which the principal's interests can be affected by, and are, therefore, dependent on, the manner in which the fiduciary uses the discretion which has been delegated to him. The fiduciary obligation is the law's blunt tool for the control of this discretion.

[5] While I will focus on Canadian corporate law, it is beneficial to state the origin of the debate. The "great debate" that occurred in the United States in the 1930s concerned whose interests directors should serve. Adolph A. Berle and E. Merrick Dodd's classic debate started the modern discussion on the topic. Dodd was of the position that

yet it identifies the purpose, the ends and means of corporations and their role in society: To whom are directors responsible?

A corporation is composed of various bodies including the board of directors, shareholders, employees, suppliers, and creditors.[6] Historically, the phrase "with a view to the best interests of the corporation" has been narrowly interpreted as directors owing a fiduciary duty to the corporation; but with the corporation's interest identified with those of the shareholder, which effectively makes the shareholders the sole recipient of fiduciary duty.[7] Further, no law existed that required directors to take into consideration the interests of the employees, the creditors, the suppliers, the consumers, and the society at large.[8] This was the

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societal interest must be served, while Berle advanced shareholders' interests, the shareholder primacy model. Please see Adolph Berle, "For Whom Corporate Managers are Trustees: A Note" (1932) 45 Harvard Law Review 1365; E. Merrick Dodd, "For Whom are Corporate Managers Trustees?" (1932) 45 Harvard Law Review 1145. In the late 1950s Berle published an article that conceded to Dodd's position of favouring societal interest over shareholders' interests. Please see Adolf A. Berle, "Power without Property, A New Development in American Political Economy" (1961) 26.2 Giugno 451-453.

For more on the American perspective around the debate and to inquire more about the American perspective and the arguments for both sides of the question, please see the collection of essays by Edward Mason. Edward Mason, ed., *The Corporation in Modern Society* (Massachusetts: Harvard University Press, 1960). Furthermore, team production theory, the alternative to shareholder primacy, which advances multiple stakeholders as the beneficiary of fiduciary duty instead of only the shareholder, has been most developed by Margaret Blair and Lynn Stout. Please see Margaret M. Blair & Lynn A. Stout, "A Team Production Theory of Corporate Law" (1999) 85 Va. L. Rev.247. [Blair & Stout, Team Production Theory] The Canadian perspective on this issue has picked up steam especially leading up to the Supreme Court's decision in *BCE.* Please see J. Anthony VanDuzer, *The Law of Partnerships & Corporations,* 3d ed (Toronto: Irwin Law, 2009). For a Canadian model of team production theory, please see the works of Stephanie Ben-Ishai, "A Team Production Theory of Canadian Corporate Law" (2006) 44 Alta. L. Rev. 299; [Ben-Ishai, A Team Production Theory of Canadian Corporate Law] and Jeffrey MacIntosh, "Directors' Duties in Canada: Paintings in a Stream?" in Adolfo Paolini, eds, *Research Handbook on Directors Duties* (United Kingdom: Edward Elgar Publishing, 2014). [MacIntosh, Directors' Duties in Canada] MacIntosh goes as far as to say that Canada must adopt federal legislation that cements shareholder primacy into law. Many other respected scholars have weighed in on this issue, and listing all of them will be too voluminous. An in-depth list appears in the bibliography.

[6] *BCE Inc. v 1976 Debentureholders, 2008 SCC 69, [2008] 3 SCR 560,* para 39. [*BCE*] *Peoples Department Stores Inc. (Trustee of) v Wise*, 2004 SCC 68, [2004] 3 SCR 461. [*People*]

[7] One of the original cases in Canadian Corporate context was the case of *Royal Guardian v Clarke*, [1914] 49 SCR 229.

[8] Please see *Parke* v. *Daily News Ltd*; [1962] Ch 927.[*Parke*] Justice Plowman states, "The view that the directors, in having regard to the question what is in the best interests of the employees, irrespective of any consequential benefit to the company, is one which may be widely held…But no authority to support that proposition as a proposition of law was cited to me; I know of none, and in my judgment such is not the law." However, it is important to note that Britain's position evolved, and the government adopted statutes that required directors to take into consideration the interest of other stakeholders.

view of the English courts, and it is known as the shareholder primacy model.[9] With the import of fiduciary duty and the shareholder primacy model to Canadian courts and the development of Canadian cases, fiduciary duty in Canada witnessed an evolution. It progressed from a narrow interpretation that exclusively benefitted the shareholders, the dominant corporate governance model in Canada for the majority of the 19th and 20th centuries, to a broader interpretation, potentially benefiting multiple stakeholders.[10] This evolution was cemented in Canada, 2008, with *BCE Inc. v. 1976 Debentureholders* (*BCE*), when the Supreme Court of Canada (SCC) decided that directors owed a responsibility to the best interest of the corporation, also allowing directors to consider the impact of corporate decisions on shareholders or particular groups of stakeholders.[11] This effectively transformed corporate governance models, as shareholders were no longer the exclusive recipients of directors' fiduciary duties.

As a result, the purpose of this thesis is to examine how corporate management is able to consider the interests of multiple stakeholders, despite the fact that the dominant shareholder primacy model remains hegemonic in practical and day-to-day operations of large corporations. The courts' emphasis in *BCE* that fiduciary duty is owed to a corporation's long-term interests has significantly allowed the emergence of an interdisciplinary model, in which shareholder primacy is relegated in favour of multi-stakeholders. No longer are directors bound to only

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[9] *Ibid.* For more information, please see Footnote 29, which explains the current British legislation on fiduciary duty using the ESV Model.

[10] I say potentially because the Supreme Court in *BCE,* para 39, citing *Peoples,* para 42 state the following: "The fiduciary duty of the directors to the corporation originated in the common law. It is a duty to act in the best interests of the corporation. Often the interests of shareholders and stakeholders are co-extensive with the interests of the corporation. But if they conflict, the directors' duty is clear — it is to the corporation." Therefore, potentially all of the stakeholders' interests can be taken into consideration in management's decision making, but only if it is aligned with the best interest of the corporation.

[11] *BCE*, *supra* note 6. The Supreme Court's decision will be discussed in much depth and it is a central part of my thesis. I do not intend to do injustice to the case by simply summarizing the court's ruling. However, it will suffice to state the current law in Canada regarding the debate, and the position of the judiciary in the ongoing conversation around the debate of to whom directors are responsible. Moreover, this approach of the SSC builds off the case of *Peoples*.

consider the interests of shareholders or only maximize the wealth of shareholders without considering the interest of the employees, creditors, suppliers, consumers, and the community at large. In addition to the emergence of an interdisciplinary model, this thesis will dispel the theory that the business judgment rule (BJR) can protect directors who do not consider the interests of multiple stakeholders in favour of the shareholders, which has been argued to be the shield that allows for continued shareholder primacy in Canada.[12]

As will be argued, various stakeholders within a corporation are currently included within the scope of the fiduciary duty as long as it aligns with the best interests of the corporation. While this is a sound principle endorsed by the SCC, in practice, it has been criticized for vagueness and uncertainty. It will be vital to provide a practical framework to transition this principle into practice.[13] While statutory readings of fiduciary duty could previously be construed as a duty that is owed to the shareholders of a corporation, this narrow interpretation only benefits the shareholder and is no longer an effective interpretation. The broader interpretation effectively expands the horizons of the fiduciary duty to include the interests of other stakeholders. For example, a fiduciary duty can extend to creditors as well as shareholders if both interests align with the best interest of the corporation.[14] This example demonstrates that creditors and shareholders are multiple stakeholders within the corporation and thus within the

[12] While this argument has been articulated in various ways, I try to dispel the notion that the BJR is a shield that protects directors against claims of breach of fiduciary duties, when such claims allege stakeholders' interests have not been considered; please see Poonam Puri, "Future of Stakeholder Interests in Corporate Governance" (2009) 48 Can. Bus. LJ at 431. "Analyzing the Supreme Court's language makes it clear that in terms of fiduciary duty post-*BCE*, a version of shareholder primacy remains."; J. Anthony VanDuzer, "BCE v. 1976 Debentureholders: The Supreme Court's Hits and Misses in Its Most Important Corporate Law Decision since Peoples" (2010-2011) 43.1 U.B.C. Law Review at 252. [VanDuzer, BCE v. 1976 Debentureholders] "An uncertain standard that varies with the circumstances and is subject to the deference of the business judgment rule reduces director and officer accountability in general. Limited remedial access for stakeholders other than shareholders and some creditors means that their prospects for holding directors and officers accountable are particularly dim."
[13] *BCE, supra* note 6 at para 38; citing *Peoples*, *supra* note 6 at para 39. For criticism of the *BCE* please refer to Footnote 56.
[14] *BCE, supra* note 6.

scope of the fiduciary duty. To reiterate, creditors or any other stakeholder, will only qualify as beneficiaries of the fiduciary duty if their interests align with the best interests of the corporation, particularly the long-term interests of the corporation.[15] Prior to presenting the theoretical framework and the methodology, it is prudent to discuss the raison d'être of this project.

The role of large, publicly traded corporations in society has evolved. It has progressed from having a minimal impact on the social fabric outside of the economic domain to obtaining the ability to influence the cultural, social, legal, and political orders of society. The conduct and behaviour of these corporations and their impact on society was witnessed in 2008 during the financial crisis -- the great recession.[16] Directors' duties and liabilities have increasingly come under scrutiny since that time. Large public firms' operations and wealth both overarch and pervade the core of social welfare, and the 2008 financial crisis is only one of a plethora of examples in which the actions taken and decisions made by large public firms have prompted severe consequences requiring immediate governmental intervention. The spiraling effect of the financial crisis included, among other things, massive job losses, enormous bailout packages that deepened national debts, the introduction of austerity measures, and the expansion of Friedrich Hayek's economic model that has dominated Western government in the 21st century.

Corporate conduct and accountability has, thus, been forced into the spotlight due to technological advances that have effectively consolidated our sense of the scope of global spatiotemporality, in which information is increasingly and more quickly accessible to larger audiences. Reports of oil spills, environmental destruction, and a host of other catastrophes can now be heard around the world in a manner of hours, if not minutes, thereby requiring

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[15] *Ibid.*
[16] For further reading on the financial crisis of 2008, please see P.M. Vasudev & Susan Watson, eds, *Corporate Governance after the Financial Crisis* (United Kingdom: Edward Elgar Publishing, 2012)

corporations to issue immediate responses as a part of their increased accountability that is only increasing in today's digital world. In those terms, it is clear that the accountability of directors and their corporations in corporate governance must be increased, thus, the scope of the fiduciary duty must be expanded to include other stakeholders alongside the shareholders, given the size of influence and impact that large corporations wield in today's society.

In a Canadian context, scholarly literature has widely discussed directors' fiduciary duties and sought to identify the beneficiaries. Questions posed in contemporary research ask who controls corporations and where directors' responsibilities lie, to which responses have often pointed to shareholder primacy. By contrast, the Canadian judiciary has been limited at best in contributing to the conversation and providing more guidance and expertise due to the low turnout of corporate law cases before the SCC and the appellate courts.[17] Arguably, the most important corporate governance legal decision in Canada has been *BCE* presented amid the global financial crisis. This case, in which an opportunity arose for the judiciary to define directors' fiduciary duties and their beneficiaries, was presented before the SCC. Since that decision, many scholars and critics have argued that the case has only further increased the vagueness surrounding the understanding of corporate governance. If the accountability of directors has become more unclear and vulnerable to abuse, will Canada's courts have another chance to further clarify the obligations of directors and thereby improve corporate governance?

Responding to the criticism and the vaguely defined obligations of directors, I will analyze how corporate governance operates by examining the current landscape of such governance in Canada. Grounding the analysis in the extensive academic literature, the Supreme Court of Canada's legal decisions and appellate judgments, and the role of the federal

[17] The cases of *Peoples* and *BCE* are the two most recent, respectively, and influential cases that examine Directors' duties in Canadian law.

government as stated in the *Canada Business Corporations Act*—particularly the duties of care of directors and officers are spelled out in subsection 122(1).[18] This thesis addresses how current corporate governance practices in Canada can be improved by articulating the obligations of directors as owed to the corporation; this can include multiple stakeholders, and not only the shareholders of the corporation. In other words, the question is whether the interests of the company are defined exclusively in terms of shareholder wealth maximization or whether the corporation should also consider other interests along the lines of the corporation's expanded liabilities under human rights laws, environmental laws, labor standards laws, insolvency laws, and other legislation that regulates the corporations' conduct toward multiple stakeholders' interests.

A major part of this project analyses and assesses the implications of that significant change, for though it might have changed in theory, many critics have argued that, in practice, directors will still govern with the priority of maximizing shareholder wealth, especially given the SCC ruling in *BCE* to grant deference to directors and officers in their business decision making via the business judgment rule (BJR). The BJR will be examined to determine if it can be used to avoid the fiduciary duty that directors owe to various stakeholders as part of the corporation's long-term interests.[19]

Theoretical Framework

The theoretical framework of this project is based on Max Weber's theory of formal rationality of the law. Weber's theory is that the law gives rise to our capitalist economic system. The law's development with predictable and certain rules and regulations has given effective rise to

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[18] I will also examine the Ontario provincial legislation. *Ontario Business Corporations Act, RSO 1990, c B.16.* Subsection 134(1) reads similarly to *Canada Business Corporations Act,* RSC 1985, c. C.44. Subsection 122(1).
[19] Please refer to Footnote 12.

capitalism, allowing merchants, institutional and individual investors, and bankers to all operate with comfort when the law is certain and predictable. Weber's theory is that the law allows for order in society, reducing irregular activities and increasing stability. It is in Weber's theory of formal rationality that this strong role for the law to allow for the growth of capitalism is discussed in depth. Weber states,

> Juridical formalism enables the legal system to operate like a technically rational machine. It guarantees to individuals and groups within the system a relative maximum of freedom, and greatly increases for them the possibility of predicting legal consequences of their action. [20]

Post-2008 financial crisis, governments worldwide enacted robust rules and regulation to increase certainty and predictability in the law and increase the accountability of corporations.[21] In 2008, the Supreme Court was essentially tasked with determining the scope of the fiduciary duty as owed by corporate management to either be provided to shareholders, and maximize their wealth or provided to multiple stakeholders, ensuring the best interests of the corporation by considering their interests. The dichotomy, thus, becomes clear: emphasis is placed either on social values and fairness to all interested stakeholders or on the maximization of wealth as a right that they value in a capitalist society. Therefore, when two values conflict with each other, the law must maintain a balance to appeal to groups that uphold each respective value. The legitimacy of the law will then be assessed when weighing both values. The Supreme Court had the task to clarify and enhance the predictability and certainty of the law.

The legal question was: "To whom are directors' fiduciary duties are owed?" This was the essential question that interested the investors who have shares in a corporation; the directors and executive officers who manage the affairs of the corporations; the creditors who lend monies

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[20]Weber, Max, Economy and Society: An Outline of Interpretive Sociology, translated by Ephraim Fischoff et al. (New York, US: Bedminster Press Incorporated, 1968) at 852.

[21] *The Dodd–Frank Wall Street Reform and Consumer Protection Act (Publ. 111–203, H.R. 4173)* is one of the most discussed ad hoc regulations enacted by the US federal government after the financial crisis in 2008.

to corporations to sustain operations, ongoing investments and projects of expansion; the employees whose labour is the underlying crux of corporate performance; and the consumers of corporate products and commodities. The SCC decided that directors owed a fiduciary duty to act in the best interest of the company and that this can include taking into account the interests of other stakeholders.[22] The criticisms that followed the decision were swift in challenging the vagueness, the unpredictability, and the uncertainty of the SCC 's ruling. The main criticism has been best articulated as follows:

> The Court [SCC] held that where conflicts arise between the interests of these different stakeholders, directors and officers must treat each stakeholder fairly in seeking 'to resolve them in accordance with their fiduciary duty to act in the best interests of the corporation, viewed as a good corporate citizen'…the Court did not provide adequate guidance regarding what is required of directors and officers under the standard it has set. The net result is that the *BCE* decision creates a new but incomplete regime for the responsibilities of corporate directors and officers, posing substantial challenges for businesses and their advisors trying to understand what it requires.[23]

I will aim to demonstrate that the principle in which the SCC has endorsed multiple stakeholders as recipient of fiduciary duty, and shifted away from shareholder primacy model is sound; however, it lacks predictability and certainty for corporate management to translate that standard into practical guidance. I will set out to assist in articulating the rationality, predictability, and certainty in practical terms and not only in principle by analyzing the shift away from shareholder primacy and toward team production theory. In order to achieve this objective, a discussion of the methodology is vital.

Methodology and Outline

In order to establish the objective of this thesis, I will rely on Supreme Court and appellate court cases as well as academic literature in corporate governance.[24] It is essential to discuss the theoretical aspects of fiduciary duty, its development in the United Kingdom, its import to

[22] *BCE*, *supra* note 6.
[23] *VanDuzer, BCE v. 1976 Debentureholders, supra* note 12 at 207.
[24] *BCE*, *supra* note 6.

Canadian law from England, and the influence of England's long-held interpretation of shareholder primacy on Canadian law. While, the focus will be on a Canadian context, use of British and American literature is necessary as Canada has imported the fiduciary duty from British common law and has been influenced in corporate governance through the extensive literature found in the United States - Delaware Revlon cases in the 20th century.[25]

The first chapter will examine fiduciary duty and its development with emphasis on the shareholder primacy model in corporate governance.[26] The interpretation of "the best interest of the corporation" was initially read by the courts to be in the best interest of the shareholders.[27] This chapter will examine the origin of shareholder primacy in Britain and its import to Canada. The focus will be Canada's evolutionary process after the import from the United Kingdom. While similar to the United Kingdom's law, there are fundamental differences; the evolution within Canadian law from the 1970s until the recent *BCE* case will be assessed. While

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[25] *Ibid* at para 86-87; The Supreme Court references the Revlon cases in the United States and states the following: [86]The "Revlon line" refers to a series of Delaware corporate takeover cases, the two most important of which are *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986), and *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985). In both cases, the issue centred around how directors should react to a hostile takeover bid. *Revlon* suggests that in such circumstances, shareholder interests should prevail over those of other stakeholders, such as creditors. *Unocal* tied this approach to situations where the corporation will not continue as a going concern, holding that although a board facing a hostile takeover "may have regard for various constituencies in discharging its responsibilities, . . . such concern for non-stockholders' interests is inappropriate when . . . the object no longer is to protect or maintain the corporate enterprise but to sell it to the highest bidder" (p. 182).
[87]What is clear is that the Revlon line of cases has not displaced the fundamental rule that the duty of the directors cannot be confined to particular priority rules, but is rather a function of business judgment as to what is in the best interest of the corporation in a particular situation. In a review of trends in Delaware corporate jurisprudence, former Delaware Supreme Court Chief Justice E. Norman Veasey stated:

> [I]t is important to keep in mind the precise content of this "best interests" concept — that is, to whom this duty is owed and when. Naturally, one often thinks that directors owe this duty to both the corporation and the stockholders. That formulation is harmless in most instances because of the confluence of interests, in that what is good for the corporate entity is usually derivatively good for the stockholders. There are times, of course, when the focus is directly on the interests of stockholders [i.e., as in *Revlon*]. But, in general, the directors owe fiduciary duties to the *corporation*, not to the stockholders.

[26] The division of corporate power relates to the role of the board of directors and their authority to manage the corporation. The authority to manage the corporation in Canada is regulated federally by the *CBCA*, and provincially in Ontario by the *OBCA*. Common law cases play a vital role in the division of power, For list of common law cases, please see R.L Campbell ed, *Accountability of Corporate Management* (Concord Ontario: Captus Press Inc, 2013).

[27] *Parke*, *supra* note 8.

shareholder primacy was an imported equitable doctrine from the United Kingdom, the Canadian courts have evolved from a narrow interpretation of fiduciary duty to a pragmatic, progressive approach in stating that fiduciary duty is now broad enough to extend to the interest of other stakeholders.[28] By identifying and analysing court cases that favoured shareholder primacy, a theoretical discussion will follow, which examines why the courts favoured a narrow interpretation of the fiduciary duty, to be owed exclusively to the shareholders. This will be followed by a critical assessment and critique of shareholder primacy, which will advance the argument that in the 21st century, this is not the appropriate model for corporate governance in Canada.

The second chapter will examine the evolution of fiduciary responsibility and shift away from a narrow interpretation that favours only the shareholders to a broader interpretation favouring multiple stakeholders. A team production theory model will be analyzed whereby fiduciary duty is owed to the corporation but also includes consideration of multiple stakeholders instead of exclusively the shareholder. Team production theory will be explored in depth, and case law will be analyzed prior to a theoretical discussion of team production theory. This will be followed by an endorsement of elements of team production theory with the caveat that maximizing the wealth of shareholders can be an objective of the board of directors as long as it is not conducted to the detriment of other stakeholders.[29]

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[28] Many will find this point contentious. Jacob S. Ziegel, "The Peoples Judgment and Supreme Court's Role in Private Law Cases" (2005) 41 Can. Bus. L.J. 236 [Ziegel, The Peoples Judgment] at 240, discusses the inconsistency of the Supreme Court stating *Peoples* decision is incompatible with 150 years of jurisprudence. However, the position of the Supreme Court has evolved and overruled its earlier narrow interpretation to transition to a multi-stakeholder interpretation of fiduciary duty. More on this will be discussed in Chapter 2.

[29] It is important to make the distinction between what I am endorsing and the enlightened shareholder value model (ESV). The ESV model is best described in the United Kingdom under the *Companies Act*, 2006, c. 46, s 172(1). This section states the following as duty to promote the success of the company.

The third, and final chapter will examine the business judgment rule and dispel the notion that the BJR can be used as a mechanism for directors to continue in their objective of maximizing the wealth of the shareholders. While the SCC in *BCE* endorsed the BJR to directors so as to not second guess their decisions, this high level of deference is not automatically granted and is done on a case-by-case basis. This chapter will examine previous cases that have discussed and listed the criteria in which courts have granted deference to the business decisions of the management of a corporation. Moreover, the appropriate conduct of the BJR will be analyzed to help frame the suitable boundaries in which directors may operate. In those boundaries, the notion of solely maximizing the wealth of shareholders will be refuted. The conclusion will include implications for future research and further endorse the team production model, arguing that Canada must not revert to the shareholder primacy model. In the 21st century, post-2008 financial crisis with increased rules and regulations, it is only fitting that directors of a corporation have their fiduciary duties expanded to include multiple stakeholders.

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(1)A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (among other matters) to

(a) the likely consequences of any decision in the long term,
(b) the interests of the company's employees,
(c) the need to foster the company's business relationships with suppliers, customers and others,
(d) the impact of the company's operations on the community and the environment,
(e) the desirability of the company maintaining a reputation for high standards of business conduct, and
(f) the need to act fairly as between members of the company.

After conducting a thorough research, I concluded that I cannot endorse the ESV model because it does not provide accountability of directors to non-shareholder stakeholders. While the ESV model's critical element is that the consideration of non-shareholder stakeholder must be taken into account, it still places shareholders at the primacy of the model. As a result, I decided it would be best not to conflate the corporate governance model that I am proposing with the ESV model. For a strong critique of the ESV model, please see the work of Andrew Keay, “Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's Enlightened Shareholder Value Approach” (2007) 29 Sydney L. Rev. 577.

Chapter 1:
Corporate Governance and Shareholder Primacy: Critical Assessment of the Narrow Interpretation of Fiduciary Duty

Automatic Self-Cleansing Filter Syndicate Co Ltd. v. Cuninghame

One of Britain's earliest cases in Corporate Law in the 20th century is the *Automatic Self-Cleansing Filter Syndicate Co Ltd. v. Cuninghame*.[30] This case was a major contributor to corporate governance as it discussed the authority vested in the board of directors and the separation between board of directors and shareholders. In regard to this separation, the judges stated the directors are not agents to the shareholders, assumed to be the principal; rather, the corporation itself is the principal.[31] In this case, there was an order by the majority of shareholders to declare *Automatic Self-Cleansing Filter Syndicate Co Ltd.* directors to carry out resolutions passed in the general meeting of the shareholders. A majority of the shareholders passed a resolution in favour of selling assets of the company to a purchaser, but the directors believed it undesirable and refused to carry out the resolution.[32]

Under articles 96 and 97(1) of the *Automatic Self-Cleansing Filter Syndicate Co Ltd.* constitution, it states that there is vested authority with the management. Both articles express that the directors shall supervise and manage the affairs of the corporations.[33] The issue before the court was whether the board of directors could be forced to comply with the resolution that was passed by the shareholders.[34] Justice Collins ruled that they did not have to do this, because the power to act had been conferred on by the board with an agreement under contract, as per the

[30] *Automatic Self-Cleansing Filter Syndicate Co Ltd vs. Cuninghame*, [1906] 2 Ch 34. [*Automatic Self-Cleansing*] at 41-43.
[31] *Ibid.*
[32] *Ibid.*
[33] *Ibid.*
[34] *Ibid.*

required regulatory standard in the early 19th century. The board of directors had the power to reject such a resolution, and the shareholders themselves gave them that power with a special resolution. Justice Collins stated:

> The majority [of shareholders] could not impose that obligation upon the directors, and that on the true construction of the articles the directors were the persons authorised to effect the sale if it were to be effected; and that unless the other powers given by the memorandum were invoked by a special resolution, it was impossible for a mere majority at a meeting to override the views of the directors.[35]

Similarly, in a Canadian context under Section 176 of the *CBCA,* a special resolution requires two-thirds of the shareholder's majority for specific actions.[36] As a result, the directors and their decisions can be overridden, but it must be done in such a manner that requires a special resolution and two-thirds of the majority.[37] A special resolution is not simply a mere majority of 50% plus one; rather, it requires two-thirds of the majority. Moreover, changing the power of the board is limited in scope, and facts of the case must render it to be special in nature. The vested

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[35] *Ibid*.

[36] *Canada Business Corporations Act,* RSC 1985, c. C.44 s 176 (1) The holders of shares of a class or, subject to Subsection (4), of a series are, unless the articles otherwise provide in the case of an amendment referred to in paragraphs (a), (b) and (e), entitled to vote separately as a class or series on a proposal to amend the articles to

- (a) increase or decrease any maximum number of authorized shares of such class, or increase any maximum number of authorized shares of a class having rights or privileges equal or superior to the shares of such class;
- (b) effect an exchange, reclassification or cancellation of all or part of the shares of such class;
- (c) add, change or remove the rights, privileges, restrictions or conditions attached to the shares of such class and, without limiting the generality of the foregoing,
    - (i) remove or change prejudicially rights to accrued dividends or rights to cumulative dividends,
    - (ii) add, remove or change prejudicially redemption rights,
    - (iii) reduce or remove a dividend preference or a liquidation preference, or
    - (iv) add, remove or change prejudicially conversion privileges, options, voting, transfer or pre-emptive rights, or rights to acquire securities of a corporation, or sinking fund provisions;
- (d) increase the rights or privileges of any class of shares having rights or privileges equal or superior to the shares of such class;
- (e) create a new class of shares equal or superior to the shares of such class;
- (f) make any class of shares having rights or privileges inferior to the shares of such class equal or superior to the shares of such class;
- (g) effect an exchange or create a right of exchange of all or part of the shares of another class into the shares of such class; or
- (h) constrain the issue, transfer or ownership of the shares of such class or change or remove such constraint.

[37] The Ontario legislation is under the *Ontario Business Corporations Act*, RSO 1990, c B.16, s 168 and 170-171.

power granted to the board of directors is not unlimited. The courts may intervene with the exercise of this power if a breach of fiduciary duty occurs.[38]

The impact of *Automatic Self-Cleansing* in common law greatly influenced corporate governance in the commonwealth jurisdictions. This case led to a separation of powers between the board of directors and shareholders in general meetings. The control of the corporation is truly with the board of directors because, as management, they are in charge of overseeing the affairs of the corporation. In overseeing the affairs of the corporation, the question, then becomes: What are the functions of the directors?

The question of what directors do is different than what they *should* do.[39] Empirical analysis of what directors do would perhaps identify part of the answer, but it would be unwise to identify every aspect of what they do, which would rely on many complexities and contexts that would limit what otherwise would be an infinite action. In other words, empirical studies cannot capture the entire picture of directors' actions and the variances from inside directors, outside directors, directors who are shareholders and directors in a family-owned corporation. This is not an exhaustive list, and what directors do is highly contingent on the context and environment in which they operate.[40] In their empirical studies, Adams, Hermalin, and Weisbach highlight the complexities in empirical studies to fully answer the question of what directors do.

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[38] As will be stated throughout chapter 2, the intervention of the court is plausible. The case study in Chapter 2 will demonstrate circumstances where the courts have intervened.

[39]This question is distinct from the question of what directors should do. This second question is answered, in part, by the legal obligations imposed by corporate law (both statutes and precedents) having to do with fiduciary obligations. For more on what directors should do, a question that I do not try to answer, please see the work of Robert Flannigan, "Corporations Controlled by Shareholders: Principals, Agents or Servants" (1986) 51 Sask. L. Rev. 23. [Flannigan, Corporations Controlled by Shareholders].

[40] The reason I am differentiating between the two is because, and for example, the board of directors in the banking industry for one of the major banks in Canada has different functions than the board of directors in the oil and gas sector. As a result, I am not asking the question of what directors *should* do because that would require an industry-specific answer. Rather, I am focusing on the "what do directors do" and focusing on the similarities among directors across multiple industries. The distinction must be made because throughout the thesis I refer to the role of

> Theory, too, faces its hurdles. Boards are only part of the corporate governance equation, but an all-inclusive model is impractical given the complexities of governance. Even limiting attention to boards, it is hard to decide which institutions should be treated as exogenous and which as endogenous. Letting too much be endogenous and the models become unwieldy and often fail to yield definitive results. Treating it too much as exogenous and critical points of joints endogeneity get overlooked, rendering conclusions that are suspect.[41]

Although directors' actions differ, it is vital to note that there are similarities in their conduct that overlap across various industries, sectors, and corporate-specific functions. Descriptive studies that were relied on noted that "directors serve as a source of advice and counsel, serve some sort of discipline, and act in crisis situations."[42] In one study it was stated that 80% of directors identified their role as involved in "setting strategy for the company."[43] Another survey noted 75% of directors responded that they had responsibility for "setting strategy, corporate policies, overall direction, mission, vision."[44] Other identifiable aspects included the hiring, firing, and assessment of management, including executive officers. In differentiating between what the directors do and what they *should do*, attention will now shift to a focus on the similarities of the functions of the board of directors.

The Functions of the Board of Directors

The role of the board can be categorized into three broad functions: management, oversight, and service expertise.[45]

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the board of directors in corporate governance. The similar overarching functions will be made and referred to throughout the thesis.

41 The empirical studies of Renee Adams, Benjamin E. Hermalin, and Michael S. Weisbach, "The Role of Boards of Directors in Corporate Governance: A Conceptual Framework and Survey" (2008) No. w14486. National Bureau of Economic Research [Adams, The Role of Board of Directors in Corporate Governance*]* is an extensive study that tries to answer the question of what directors do, i.e., the general function of directors over multiple corporate industries.

42 *Ibid* at 6.

43 *Ibid* at 7.

44 *Ibid.*

45 Stephen M. Bainbridge, "Director Primacy: The Means and Ends of Corporate Governance." (2002) 97 Nw. UL Rev. at 562. [Bainbridge, Director Primacy]

Management

In its most basic definition in corporation governance, management administers the functions of the corporations. Directors are vested with the power to manage the firm.[46] This power includes the need to authorize important decisions that impact the whole firm, such as mergers and acquisitions, control of corporate assets, bond issuance, shares, and supervising the management of the day-to-day operations.[47] Large corporations delegate the routine operations to senior officers. An example of this management is reflected in Rogers Communications, one of Canada's largest telecommunications public corporations. They state the Board's mandate as follows:

> The Board is responsible for the stewardship of the Company. This requires the Board to oversee the conduct of the business and affairs of the Company. The Board discharges some of its responsibilities directly and discharges others through committees of the Board. The Board is not responsible for the day-to-day management and operation of the Company's business, as this responsibility has been delegated to management. The Board is, however, responsible for supervising management in carrying out this responsibility.[48]

The mechanism of management is also mandated by the *Canadian Business Corporations Act*. Under Subsection 102. (1): "Subject to any unanimous shareholder agreement, the directors shall manage, or supervise the management of, the business and affairs of a corporation." Provincially in Ontario, it is the *Ontario Business Corporations Act* under Subsection 115(1).[49]

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[46] I interchangeably use the words "firm" and "corporation." In discussion of the firm I am usually referring to the internal corporation, whereas corporation refers to the external, independent corporation.
[47] *Bainbridge, Director Primacy*, *supra* note 45 at 624.
[48] Rogers, Board of Directors Mandate, retrieved online from < http://www.rogers.com/web/ir/corp-gov/directors-mandate>.
[49] The legislation of both Canada and Ontario read similarly: *Canada Business Corporations Act,* RSC 1985, c. C.44, s 102; *Ontario Business Corporations Act,* RSO 1990, c B.16.s 115. (1): Subject to any unanimous shareholder agreement, the directors shall manage or supervise the management of the business and affairs of a corporation. Other provinces have also adopted legislation that regulates business corporations. Due to the voluminous literature on each provinces' regulations, I have only focused on the federal and Ontario legislation. Furthermore, statutory legislations, case law and precedents have filled in the substance of the broader management role to define more specifically what management is. This will be discussed in detail in Chapter 2.

Oversight and Services

Due to the board delegating its day-to-day authority to managers, the board of directors are responsible for appropriately hiring executive managers. This includes monitoring, assessing performance, and also setting the appropriate compensation packages for their positions and performance. The oversight mechanism also requires the board of directors to authorize large-scale transactions, and that requires them to approve mergers and acquisitions. This usually occurs in annual meetings of the board of directors or *ad hoc* emergency meetings where large scale transactions are approved.[50]

Service is another category of functions. Directors might provide expertise by virtue of their appointment to the board. For example, the sole function of outside directors in a corporation might be to ensure that environmental regulations are met or human rights legislations are respected vis-à-vis the operations of the corporation. Directors can also provide their services if they are, by training, lawyers, academics, accountants, or any other expert in a well-defined profession.

The three main identified categories are not necessarily balanced, but rather they are contingent on the operation, mission, and type of corporation. The balance of the three functions might tilt toward management or services or oversight. It is a context-based approach that depends on the corporation itself as well as the composition of individual member's strengths. The board of directors might require a service based director who, for example, is a professional accountant. That director is hired on a specific mandate for his/her expertise in accounting.

[50] The functions can be found in the constitution of corporations, but it is also mandated by the Federal and Provincial Regulation. *Canada Business Corporations Act* and *Ontario Business Corporations Act.*

Another example is a former Minister of the Crown, would be able to offer political expertise on governance.

As laid out by Subsection 102(1) and 115(1) of the *Canada Business Corporations Act* (*CBCA*)*,* and the *Ontario Business Corporations Act* (*OBCA*) respectively, directors shall manage, or supervise the management of, the business and affairs of a corporation.[51]

In identifying the functions of directors, it is crucial to discuss the fiduciary duties of the directors and to whom their duties are owed. If directors are required to act honestly and in good faith with a view to the best interests of the corporation, should they focus on the narrow interpretation by only considering the interest of shareholders and solely seek to maximize their wealth? Or, should directors shift their attention to focus and consider the interests of various stakeholders of a corporation? The various stakeholders of a corporation can be limited or wide-ranging. Identifiable groups of stakeholders in public corporations include shareholders, creditors, suppliers, consumers, employees, and the communities in which operations of the corporation take place vis-à-vis the society at large.[52]

The narrow interpretation of the fiduciary duty assumes that the best interests of the corporation are also the best interests of the shareholders. Such narrow interpretation will be analyzed through case law and an assessment of the theoretical perspective that gave rise to exclusively favouring the shareholders, Scholarly literature that has favoured shareholder primacy will be examined.[53]

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[51] *Canada Business Corporations Act,* RSC 1985, c. C.44, s 102. *Ontario Business Corporations Act,* RSO 1990, c B.16.s 115. (1).

[52] To narrow the scope of the debate, I will zoom in on two specific stakeholders of the corporation that must have their interests considered: the creditors and the shareholders.

[53] Scholars who have endorsed the shareholder primacy model in Canada have been vocal in their support. Although the list of scholars is too voluminous to list, I will identify the leading scholars including Jeffrey MacIntosh and

Royal Guardians v. Clarke

In discussing whose interests the board of directors should consider, early common law cases were clear in identifying the interest of the shareholders with the interest of the corporation itself. *Royal Guardians v Clarke*[54] is one of the earliest Canadian cases where the SSC decided that the interests of the shareholders are the interests of the company. The reason that shareholders' interests were perceived as the interest of the corporation is because they were thought to control the corporation by proxy votes. This is an extension from the British cases, which also emphasized the rights of shareholders' interests in the corporation. The SCC states:

> In the management of its businesses these officials in the case of mutual-benefit societies represents the members of the society, who are its owners and presumably have entrusted the management of its affairs to such officials because they repose confidence in them, quite as much as the directors and high office holders in the joint-stock company represents its owners, the shareholders.[55]

While this is a Canadian case, the view that the rights and interests of shareholders should be given primacy was imported to Canadian law via Britain. *Foss v Harbottle* and *Hutton v West*[56] were the earliest precedents in Britain that favoured shareholder primacy. *Greenhalgh v Arderne Cinemas*[57] is another British case law, which was determined later.

Anthony VanDuzer. Please see Jeffrey MacIntosh, "*BCE* and the Peoples' Corporate Law: Learning to Live on Quicksand" (2009) 48 Can Bus LJ 255; MacIntosh, Directors' Duties in Canada, *supra* note 5; VanDuzer, BCE v. 1976 Debentureholders, *supra* note 5.

[54] *Royal Guardian*, *supra* note 7.

[55] *Ibid* at 269. Although the court has mentioned it in obiter dicta, it is still vital to note the position of the SCC was similar to the British position, indicating that the shareholders are the owners of the corporation. Jeffrey MacIntosh, "Directors' Duties in Canada, *supra* note 5, highlights several cases that demonstrate the initial position of the courts, which is pro-shareholder primacy.

[56] *Foss v Harbottle*, [1843] 2 Hare 460, 67 ER 189; *Hutton v West, [1883] 23* Ch D. 654 CA

[57] *Greenhalgh v Arderne Cinemas*, [1951] Ch. 286 CA.

Greenhalgh v. Arderne Cinemas

In this case, the British Court of Appeals held that the shareholders, who own the majority of the shares of a corporation, controlled the company. While this ruling came in 1951, earlier cases held the same view in Britain[58] and were very consistent in advancing the shareholder primacy model. Justice Evershed M.R stated,

> The phrase 'the company as a whole' does not mean the company as a commercial entity, distinct from the corporators [i.e. the shareholders]; it means the corporators as the general body, that is to say the case may be taken of an individual hypothetical member and it may be asked whether what is proposed is in the honest opinion of those who voted in its favour, for that person's benefit.[59]

The courts have emphasized the invention of the shareholders as the controllers of the corporation. The directors' duties are owed to the best interests of the corporation, and the corporation as a whole is not distinct from the shareholders. This was reaffirmed in the UK in the case of *Smith & Fawcett Ltd.,* which demonstrated the clarity of the court in this ruling two decades later. The case of *Parke v. Daily News Ltd.* also reaffirmed that the best interest of the corporation is the best interest of the shareholders.

Re Smith & Fawcett Ltd.

In this case, the directors refused to register share transfers to Mr. Fawcett's executor after his death.[60] The directors' refusal to register the share transfers was a discretion; accordingly, their discretion was their business decision.[61] The autonomy provided to the board of the directors allowed them to exercise discretion, and this was a business judgment; under the BJR, it is not reviewed by the courts. The courts can, therefore, grant deference to business decisions decided

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[58] Earlier British cases advancing shareholder primacy were the following: *Foss v Harbottle*; and *Hutton v West.*
[59] *Greenhalgh , supra* note 57.
[60] *Re Smith & Fawcett Ltd; CA 1942*, Ch 304. [*Fawcett*]
[61] *Ibid.*

by the boards of courts.[62] More importantly, the court stated that discretion granted to the board of directors must be done in good faith and in the best interests of the corporation. Lord Greene stated that it was beyond question a fiduciary power, and the directors must act "*bona fide* in what they consider—not what the court may consider—is in the [best] interests of the company."[63] The court's judgment reaffirmed the decision in *Automatic Self-Cleansing Filter Syndicate Co Ltd. v. Cuninghame* that the directors truly control the corporation and not the shareholders. This demonstrates that *Greenhalgh v. Arderne Cinemas and Royal Guardians v. Clarke* was an exception, and that neither shareholders' voting rights nor their interests translate into control of the corporation.

The court's judgment in *Re Smith & Fawcett Ltd.* stated that the board of directors would decide what was in the best interests of the corporation. The courts do not determine this for corporations; however, the courts will examine whether proper consideration is made when the directors decide the best interests of the corporation. Moreover, the board must exercise their power for the purposes of which they were conferred, not for collateral purposes. This can be determined by the articulation of power granted to the board by a special resolution in a general meeting and/or upon the creation of a corporation and its articles of a constitution. In this case, the courts stated:

> The question, therefore, is simply whether on the true construction of the particular article the directors are limited by anything except their *bona fide* view as to the interests of the company. In the present case, the article is drafted in the widest possible terms, and I decline to write into that clear language any limitation other than a limitation, which is implicit by law, that a fiduciary power of this land must be exercised *bona fide* in the interests of the company.[64]

[62] The business judgment rule (BJR) will be discussed in-depth in chapter three. However, it will suffice to say that the courts do not grant deference to the BJR on every occasion; rather, it is limited in scope and must meet the judiciary's required criteria. These criteria will be stated in Chapter three.
[63] *Fawcett*, *supra* note 56.
[64] *Ibid.*

This demonstrates a cautious approach by the courts and respects the decisions made by the board of directors while simultaneously examining the appropriate consideration of the best interests of the corporations. The courts grant directors of corporations deference through the business judgment rule (BJR), where they attempt to respect the decision made by the directors by not second guessing their decision. The third chapter will thoroughly examine the BJR; however, it will suffice to state that, as Stephen Bainbridge asserts, the BJR is the chief corollary between ownership and control of the corporation.[65] This means that the courts will examine tension between the authority of the directors, as they control the corporation, and what the shareholders perceive as their right as "owners." As demonstrated in *Automatic Self-Cleansing Filter Syndicate Co Ltd. v. Cuninghame*, *and in Re Smith and Fawcett Ltd.,* directors are truly in control of the corporation. However, in *Greenhalgh v. Arderne Cinemas*, the courts stated that the shareholders' interests are the interests of the corporation, because it was perceived that shareholders "own the company." As a result, Bainbridge's statement that the BJR is the chief corollary between ownership and control of the corporation highlights the court's approach in dealing with the tension between directors and shareholders on a case-by-case basis.

In *Parke v. Daily News Ltd.*, the courts reaffirmed that the best interest of the corporation is the best interest of the shareholders.

Parke v. Daily News Ltd.

This case enforced the narrow interpretation of fiduciary duty of the corporation to only consider the interests of the shareholders. The board of directors of Daily News Ltd.[66] decided to sell the subscription lists and production facilities of their newspapers to Associated Newspapers Ltd.

[65] Bainbridge, *supra* note 45, 601.
[66] *Parke*, *supra* note 8. The board of directors of Daily News Ltd was primarily managed by the Cadbury family, who controlled the News Chronicle and Star Newspapers.

due to sustained losses in publications.[67] However, at the general meeting to authorize the distribution of the money in accordance with the arrangement, Parke, a minority shareholder, objected because he believed that the shareholders should be the recipients of that money, not the employees.[68] Parke believed that the Cadbury family should have claimed dividends after the liquidation and distributed it to the shareholders.

The Cadbury family argued that the company would thereby be guilty of a breach of good faith against Associated Newspaper Ltd., its employees, and the trade unions if they did not provide the rewards and benefits to the employees. Parke brought up the action as a resolution to give employees a lump sum of pay in the best interest of the corporation. Justice Plowman stated that the directors' actions constituted a breach of fiduciary duty. He stated,

> The view that the directors, in having regard to the question what is in the best interests of their company, are entitled to take into account the interests of employees, irrespective of any consequential benefit to the company, is one which may be widely held.[69]

Justice Plowman continued,

> No authority to support that proposition as a proposition of law was cited to me; I know of none, and in my judgment such is not the law.[70]

The ramification of this case favoured the narrow interpretation of fiduciary duty, considering only the interests of the shareholders. Justice Plowman stated:

> The directors of the defendant company are proposing that a very large part of its funds should be given to its former employees in order to benefit those employees rather than the company [shareholders].[71]

The interpretation of benefiting the employees instead of the company is construed as benefiting the employees instead of the shareholders. According to the court, because the claim was made

[67] The arrangement between Daily News Ltd. and Associated Newspapers Ltd. resulted in many employees losing their jobs; as a result, the money received by the Daily News Ltd. would be paid to those redundant employees as a reward for their efforts in operating the News Chronicle and Star Newspapers, mainly as compensation and pension benefits.
[68] *Parke*, *supra* note 8.
[69] *Ibid*.
[70] *Ibid.*
[71] *Ibid.*

by a minority shareholder, the board of directors should have claimed dividends on the money and given shareholders their share. Because the board provided the employee with bonuses, they did not act in the best interest of the corporation, which is also the best interest of the shareholders. The employees' interest is inconsistent with the best interest of the shareholders.[72]

Many economists and pro-shareholder primacy scholars favoured this narrow interpretation of fiduciary duty, which only considered the interests of shareholders.[73] This essentially advances shareholder primacy. The following sections will examine the foundation and the objectives behind advancing shareholder primacy from a theoretical perspective.

Shareholders are Residual Claimants; Non-Shareholder Stakeholders are Fixed Claimants

One central arguments advanced by pro-shareholder primacy advocates is that all non-shareholder stakeholders have their interests considered by directors via legislation or contracts, identified as fixed claimants, while the shareholders are considered residual claimants.[74] According to the economic view of fiduciary duty, employees and any non-shareholder stakeholder have no personal relationship with the firm. The only stakeholders in the firm are the shareholders, and the board of directors' role is to maximize their wealth.[75]

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[72] This is according to the judgment in *Parke -v- Daily News Ltd*.
[73] Please refer to footnote 53.
[74] The argument that fixed claimants of the corporation have their interest considered by directors through explicit contract or legislation is one that has been advanced by many scholars who favour shareholders. For example, Ontarian directors are liable to employees if their wages are not paid to them. (In the *Ontario Business Corporations Act,* RSO 1990, c B.16. s 131.(1)) The directors of a corporation are jointly liable to the employees of the corporation for all debts not exceeding six months' wages that became payable while they were directors for services performed for the corporation and for the vacation pay accrued while they are directors for not more than twelve months. As a result, because there is an explicit statute that makes directors liable for employees' wages, fiduciary duty should not be extended to the employees of the corporation. For more on this line of argument, please see the work of Oliver Hart, "An Economist's View of Fiduciary Duty" (1993) 43 U.T.L.J. 299 [Hart, Economist's View]; Jonathan R. Macey and Geoffrey P. Miller, "Corporate Stakeholders: A Contractual Perspective" (1993) 43 U.T.L.J. 401; R. Daniels, "Can Contractarianism be Compassionate? Stakeholders and Takeovers" (1994) University of Toronto Law Journal.
[75] Hart, Economist's View*, Ibid* at 306.

The economist's view is that fiduciary duty must have a narrow interpretation; that is, to focus only on maximization of shareholder wealth. After all net costs have been deducted from the revenue of the company, the remaining profit is for shareholders.[76] As a result, the shareholders are residual claimants who are not paid with a fixed amount, and, thus, they are the most in need of protection. The need for protection for shareholders is vital, because other stakeholders have protection via legislation or direct contracts with the corporation.[77] Allowing for a broad interpretation of fiduciary duty is detrimental. "A broad definition of fiduciary duty is essentially vacuous, because it allows management to justify almost any action on the grounds that it benefits some group."[78] For example, large public corporations after paying all expenses will be left with a profit. Management must then decide whether all of the profits should be given to shareholders as return on their investment, or whether it should go toward an increase in employee wages.[79] In the shareholder primacy model, shareholders must gain from the profit because not doing so represents 'deleterious efficiency consequences. "This has deleterious efficiency consequences to the extent that it makes it hard for the firm to raise equity capital."[80] This occurs when investors, the shareholders, do not invest in corporations that will not provide them with the highest return on their investment. Shareholders will leave those corporations in search for other corporations that will maximize their investment and, thus, their wealth.[81] Fewer investments in a corporation will hinder growth and the potential to cut down on operations, and, as a result, other stakeholders' situations will not improve in the long term. While other stakeholders, for example employees, might benefit from an increase in wages, in the long term

[76] *Ibid*.
[77] *Ibid* at 303.
[78] *Ibid*.
[79] This is an example that aims to demonstrate the potential conflict in corporate management decision making. Of course, there are other considerations for management to consider. This is not to say dividing the revenue between the shareholders and the employees is the only choice for management. Rather, it is an example.
[80] Macey and Miller, *supra* note 74 at 418.
[81] *Ibid*.

shareholders might not be interested in watching their investments not reaching its full potential. Thus, when they no longer invest in the corporation, it will lead to losses for employees in the long term as fewer investments in the corporation can lead to fewer opportunities for the employees. The corporation as a result might decline to hire new employees and delegate more responsibilities to the current employees.[82] A basic premise of corporate law is then to ensure enhancing the profit for shareholders. Melvin Aron Eisenberg states the following:

> The business corporation is an instrument through which capital is assembled for the activities of producing and distributing goods and services and making investments. Accordingly, a basic premise of corporation law is that a business corporation should have as its objective the conduct of such activities with a view to enhancing the corporation 's profit and the gains of the corporation 's owners, that is, the shareholders'.[83]

Shareholders are the Most Vulnerable Group

"Once we view the shareholders as simply the residual claimants who have agreed to accept a more uncertain future return because of their superior risk-bearing capacity, it is far from self-evident that shareholders are necessarily entitled to control the firm."[84]

The rationale for the fiduciary duty being equated with the interests of the shareholders is because every other stakeholder can benefit from a fixed contract, and because the group that benefits the most from bearing the highest level of risk is the shareholders. Thus, the loyalty and conduct of directors must be solely focused on shareholders.[85] To put it in perspective, the following example is provided. Not every stakeholder is as interested in the overall profitability of the corporation as the residual claimants; that is, the creditors and employees, among other stakeholders, are fixed claimants who would like to see a return, or in other words, a "repayment" on their claims and would tend to be risk-averse claimants.[86] As a result, they have less interest in the overall economic performance of the corporation. Moreover, they have the

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[82] *Ibid*.
[83] Melvin Aron Eisenberg, "An overview of the principles of corporate governance" (1993) The Business Lawyer at 1275.
[84] Macey and Miller, *supra* note 74 at 406.
[85] *Ibid* at 411.
[86] *Ibid*.

ability and bargaining tools to negotiate better contract protection with the corporation. Therefore, creditors or employees do not need representation on the board to assess and monitor all aspects of the firm's performance.[87] Continuing with this line of argument, the exclusivity of fiduciary duty must then be to shareholders.[88] The pro-shareholder argument holds that there is a gap between stakeholders that are contracting with the corporation and being a shareholder.[89] Fiduciary duty as an equitable legal doctrine fills that gap. As previously mentioned, every stakeholder is a fixed claimant, and because of this status, their contracts can specify obligations that are usually not afforded to shareholders. Fiduciary duty is then the mechanism invented by the legal system in common law.[90] It is the common law precedents that have created fiduciary duty to allow shareholders to have protection. "Fiduciary duties are the mechanism invented by the legal system for filling in the unspecified terms of shareholders' contingent contracts. These duties run solely to shareholders because they are the residual claimants of the corporation."[91] Moreover, "The gains and losses from abnormally good or bad performance are the lot of the shareholders, whose claims stand last in line."[92] For example, if a corporation had revenue of ten million dollars at the end of their fiscal year, the employees as fixed claimants would have their wages deducted from the revenue. The cost of production would then be subtracted. It might include payment for equipment, suppliers of products, creditors who have been providing the monetary support to maintain the operation, various levels of government that receive taxes, and finally the net profit would go to the shareholders, the residual claimants. If the corporation takes on new operations and productions, it then becomes;

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[87] *Ibid* at 417.
[88] *Ibid*.
[89] *Ibid*.
[90] Chapter 2 will focus on fiduciary duty. It will suffice to say that fiduciary duty is an equitable doctrine that originated in common law.
[91] Macey and Miller, *supra* note 74 at 423;
[92] *Ibid*; Frank H. Easterbrook, and Daniel R. Fischel, "Voting in Corporate Law" (1983) 26.2 The Journal of Law & Economics at 403.

> "Those with fixed claims on the income stream may receive only a tiny benefit (in increased security) from the undertaking of a new project. The shareholders receive most of the marginal gains and incur most of the marginal costs. They, therefore, have the right incentives to exercise discretion [or to have it exercised on their behalf]."[93]

To further understand the claim of shareholders being residual claimants, the concept of fixed claimants must be examined further. For example, employees at the time of hiring will have their wages and benefits dictated by a contract stipulating they work for the corporation. Suppliers, when contracted for requests and orders, will either be paid at time of the request, or if there is an ongoing need for certain products for operational purposes, a long-term contract that dictates the cost will be fixed to ensure continued operational requirements are met and sustained. The benefits of having fixed contracts increase the predictability and certainty with the employees and suppliers. Creditors are also beneficiaries from the need of fixed contracts. If the rate of return on borrowed credit is a known fixed variable, it will then allow for a continuous transaction with the corporation, similar to the supplier. This is mostly true in terms of a long-term relationship with the corporation.

Fixed claimants also enjoy regulatory protection provided by federal and provincial legislation, and by regulatory standards ranging from labour to occupational health and safety to environmental.[94] Moreover, employees, and managers in addition to fixed contracts that stipulate wages and benefits, might incur bonuses that are dependent on the performance of the corporation. This can potentially be done to encourage productivity and efficiency of employees whose labour dictates the performance of the corporation. Employees' interests might not align with other groups' interests in the corporation. The employees' concerns might be geared

[93] *Ibid.*
[94] *Ibid.*

toward their pensions or available health insurance and sick leave. As a result, the argument then translates into one where all of the concerns of the employees and other fixed claimants can be flushed out and discussed at times of contract negotiations.[95] Therefore, all three different stakeholders, creditors, employees, and suppliers, are fixed claimants. The argument then becomes that shareholders, because they are not fixed claimants, must have extra protection that will allow the directors and managers to ensure their interest is a central part of directors' decision making. It is the role of fiduciary duty, as owed exclusively to shareholders, to fill that gap.

The Economic Efficiency of Fiduciary Duty: The "Too Many Masters Argument"

Narrow interpretation of fiduciary duty is said to allow for easier management decision making for the board of directors. "Consider a takeover bid made at a substantial premium over current share price. It may be hard for management to reject this bid out of hand if it owes a fiduciary duty exclusively to shareholders."[96] However, if fiduciary duty is extended to include the interests of various stakeholders, the management may become aware of the interest of a group that might be negatively impacted from the takeover, and, could, theoretically, on this basis reject the bid. To reiterate, management of a corporation will find it difficult to take into consideration every stakeholder's interest in major business decision making that will impact the whole corporation. The reason for this difficulty is that the likelihood of one stakeholder to disagree with the management will be greater. As a result, if fiduciary duty is owed to multiple

[95] *Ibid*.
[96] Hart, Economist's View, *supra* note 74 at 305.

stakeholders, claims of breach of fiduciary duty will be a cause of concern as it opens up the management of the corporation to liability.[97]

This is known as the "too many masters" argument,[98] and instead of directors focusing on multiple stakeholders, their focus should be shifted toward the shareholders. The argument is that in the decision-making process directors must only consider the interest of the shareholders as to not create inefficiency that is detrimental to the corporation. This is especially true if there are conflicts of interests among various stakeholders. Take for example, the possibility of a corporation relocating to another town in order to reduce operational costs, or the possibility of a corporation shifting its operations to focus on client-based services targeting a specific demography. Directors and managers in boards will then need to assess the best available options for the corporation, this include taking into consideration the interests of multiple stakeholders. The option to reject the takeover might benefit long-time consumers, employees, and the community at large where the corporation is operating. The option to relocate if the takeover is successful will increase the premium of shares for the shareholders. The creditors will be paid and might benefit from an increase in operations if the takeover is successful. The argument for too many masters is that directors will not be able to make decisions that are best for the corporation because of too many considerations; therefore, the corporation will be left with an option that appeals to the majority of the stakeholders but is detrimental to the best value of the corporation and potentially to shareholders. Moreover, the argument for serving too many masters is concerned with the fact that directors and managers might substitute or disguise their interest for another stakeholder's interest.[99] In terms of relocating, directors and managers might

[97] *Ibid*.
[98] *Ibid*.
[99] Easterbrook & Fischel, *supra* note 92 at 418; Hart, Economist's View, *supra* note 74 at 416; VanDuzer, *supra* note 12 at 248.

argue that it is not in the best interest of the employees to relocate. However, in reality, it can be directors that are self interested in not relocating but disguised as the employees' interest. This has been a primary concern for the argument that favours shareholder primacy. There is a fear that too many masters will veil the self interest of the managers, clouding their judgment to act in the best interest of the shareholders, thereby reducing the accountability of directors and managers.[100]

The abovementioned arguments favouring shareholder primacy have also been advanced by other forms of corporate governance models. Contractarian theory and Director Primacy are also models of corporate governance that operate with the core belief that the objective of the firm is to maximize the wealth of shareholders while not advancing shareholder primacy.[101] All shareholder primacy arguments favour a narrow interpretation of fiduciary duty where the corporation's interests are equated with those of the shareholders. Many of these arguments are economic in nature and, thus, require an economic assessment as to how to best demonstrate that the only beneficiary of fiduciary duty must be the shareholders. Critical assessment of pro-shareholder arguments will demonstrate the need to rethink maximization of shareholders' wealth if it conflicts with the best interest of the corporation.

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[100] *Ibid*.

[101] **The Perspective of Contractarians:** Other theories of corporate governance have operated with the objective of maximizing the wealth of shareholders. Contractarians view the corporation as a nexus of contracts between various groups with the duty of the board of directors to minimally meet those contracts and distribute the profit of the enterprise to the shareholders while working toward maximizing the wealth of the shareholder as the end goal. This is still a notion of the broader principal-agent model. Maximizing the wealth of shareholders should not to be confused with shareholder primacy. While shareholder primacy's sole objective is to maximize the wealth of shareholders, other theories of corporate governance have the same objective, and as a result, it is necessary to note that shareholder primacy and maximizing the wealth of shareholders are not necessarily the same concepts. Director primacy also involves the objective of maximizing the wealth of shareholders, and tries to disprove shareholder primacy, but is not opposed to maximizing the wealth of shareholders.

Maximizing the Wealth of Shareholders: Critical Analysis

The normative belief of corporations is to maximize the wealth of shareholders, as advanced by the pro-shareholder primacy model. The belief is that shareholders are the residual claimants, and they delegate the management of the corporation to the board of directors who then provide stewardship, guidance, and authority to delegate day-to-day operations of the corporations to employees and officers. Their theory is principal-agency. The shareholder is in theory the principal and the agents are the management (which include the board of directors and executive officers), and the role of the agents is to maximize the firms' earnings for the principals, the shareholders.[102]

Accordingly, the end goal of corporate governance and the prime fiduciary obligations of the director are to then maximize the wealth of shareholders. Extensive research on why various scholars believe the goal of corporate governance is to maximize the wealth of shareholders primarily narrows down to one major factor: all other stakeholders of the firm are provided protection through contract and legislation, and it is only the shareholder that is the residual claimant who by theory of bounded rationality, will seek maximization of utility, and that is wealth.[103]

Philosopher John Rawls' description of classical utilitarianism is that "society is rightly ordered, and, therefore, just, when its major institutions are arranged so as to achieve the greatest net balance of satisfaction summed over all the individuals belonging to it."[104] Kent Greenfield and John Nilsson describe the two components of utilitarianism as satisfaction and

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[102] Robert Flannigan, "Corporations Controlled by Shareholders: Principals, Agents or Servants", *supra note 39.*
[103] *Ibid.*
[104]Kent Greenfield, and John E. Nilsson, "Gradgrind's Education: Using Dickens and Aristotle to Understand (and Replace?) the Business Judgment Rule" (1998) 63 Brooklyn Law Review, 810-12. Kent Greenfield and John E. Nilsson, examine the metric measure of corporate governance, one sort of decision making, to maximize the wealth of shareholders. [Greenfield & Nilsson, "Gradgrind's education"]

maximization, which represent the optimal arrangement of society. They rely on the concept that "utilitarianism was and is about, or lends itself to, a particular sort of economics—the kind of laissez-faire approach associated with economic libertarians." This form of economics has been advanced by leading economists, such as Milton Friedman.[105] As a result, utilitarianism is then applied to corporate governance through evaluation of one single criteria, an overarching goal, which is the maximization of shareholder wealth. This is also known as the "metric measure of corporate governance." The critique of utilitarianism of corporate governance and the maximization of shareholders' wealth was that form of corporate governance where the single objective, maximizing the wealth of shareholders, is irrational.[106]

> Utilitarian economists could very consistently develop a model of human choice that would set as the standard the maximization of personal preferences and imbue this model with a normative dimension. All choices must be analyzed as to that one value. All other 'goods' are to be taken into account only if they are commensurable with that one measure. Choices are well made when they serve that goal and poorly made when they do not. Dickens's critique that utilitarianism is irrational insofar as it requires a dependence on commensurability and maximization-must be taken seriously when applied to corporate law.[107]

Commensurability and shareholder primacy are irrational because they rely on a single requirement, wealth maximization.[108] In corporate governance it is irrational for directors' and officers' main objective to be maximizing the wealth of shareholders, assessing large transactions based on a single requirement - a single value - of generating the largest dollar value as a return. It is described as "irrationality of a utilitarian calculus."[109] As a result, advocating for maximization of shareholders' wealth does not necessarily correspond to the best interest of the corporation. A narrow conception of fiduciary duty to allow boards of directors to only focus on the interests of the shareholders is irrational, because its focus is on short-term maximization of

[105] *Ibid* at 813. Greenfield and Nilsson cite the work of Richard Posner. Please see Richard A. Posner, *Overcoming Law* (Boston: Harvard University Press, 1995).
[106] The form of irrationality is based on Charles Dickens' concept, the critique of utilitarianism. Charles Dickens, *Hard Times 1854* (Kate Flint ed., Penguin Books 1995).
[107] Greenfield & Nilsson, "Gradgrind's education", *supra* note 104 at 816.
[108] *Ibid*.
[109] *Ibid*.

wealth. The focus must rather be toward an increase in the long-term value of the corporation. This also increases shareholders' value. However, it does not exclusively increase the wealth of shareholders; it also increases the overall value of the corporation, thus benefiting employees, creditors, suppliers and all other stakeholders.[110]

Arguments of the narrow interpretation of fiduciary duty or "economic efficient fiduciary duty" confuse the exclusive interests of shareholders and the long-term interests of the corporation. This is true especially in takeovers; takeover bids are very specific examples that often require a board of directors to take into account the interest of more than one group.[111] The decision must benefit the corporation at large. Takeover bids are assessed with a view toward long-term interests, not only for shareholders but for various groups, and efficiency will require a long-term interest that cannot be ignored or overlooked. Shareholder exclusivity will subject management decisions to short-term gain at the detriment of the corporation in the long term.

Moreover, the assertions contained in the "deleterious efficiency consequences" are based on assumptions.[112] The first major assumption is that decisions about the profits of a corporation are binary, either to distribute that profit toward employees or toward shareholders, and that one group must gain at the expense of another. That is a false assertion because profit does not necessarily need to be directed to any group of stakeholders. It can be directed to both groups. Employees of corporations who receive an annual two percent increase can have their

[110] Prior to the end of chapter two, I will discuss the proposed alternative to the shareholder primacy. Suffice to say, it consists of elements of the team production theory - a multiple stakeholder beneficiaries of the fiduciary duty as owed by the directors of the corporation.

[111] In theory, if the corporation is faced with the prospect of a takeover bid that involves several elements that will gradually impact the corporation, the board of directors are required to take into account the interest of more than one group regardless of the fiduciary duty being owed exclusively to shareholders or to multiple stakeholders. Takeover bids, or any other significant decision must benefit the corporation at large.

[112] After listing the first set of arguments in favour of shareholder primacy, I try to debunk those arguments. Throughout this thesis I argue that shareholder primacy is no longer the appropriate model for corporate governance. The model that is being proposed is a mixture of shareholder primacy and team production theory, with heavy reliance on the latter.

earning needs addressed, while shareholders gain the bigger percentage of the profit. If a company does not meet its expected profit, the employees will still be able to gain their annual raise, as it is fixed. As a result, shareholders who may not see gains in an unprofitable year will still have a larger percentage over a longer period. Short-term decline in shareholders' profits will still not have as large an impact as changes have for employees on a fixed income, as they are risk averse and their productivity is not based on company profit. Shareholders will gain more during higher profit years, and gain less during periods of lower profit. The corporate financial cycle will fluctuate meaning shares can increase or decrease, but because shareholders are not on a fixed income, their profit is based on the performance of the corporation.

The question that still remains is: Do employees receive bonuses, effectively sharing the profits with shareholders? While shareholders get a larger return, and their investment might not be maximized, deleterious efficiency consequence can still occur because shareholders are not receiving the maximum potential on their investment. While, this is a strong argument advanced by the pro-shareholder primacy model it is not backed by data. It must be critically assessed from the perspective of industry practices. The practice of providing employees with bonuses is not novel. Moreover, empirical studies suggest that shareholders do not invest in corporations because of the potential of not earning the maximum on their investment. There are multiple reasons why shareholders do not invest; however, none are the result of management providing bonuses to employees.[113]

In addition, the previously mentioned argument of "too many masters to serve" does not carry weight due to increased legislation. If the fiduciary duty has not yet been broadened to include multiple stakeholders as beneficiary of directors' fiduciary duty, then the development of

[113] In conducting research for this project, I have yet to come across empirical studies that suggest providing employees with a bonus is detrimental to the corporation or that shareholders withhold investments for that reason.

higher regulatory standards for the environment, employees, creditors and stronger consumer protection will broaden the scope of the fiduciary duties. However, will the fiduciary duty, a broadened one that includes multiple stakeholders, be economically inefficient? Economic inefficiency due to stronger regulation is an argument that has faced considerable criticism. One of the main criticisms is that increased regulation benefits the corporation in the long term. As risk-management planning demonstrates through empirical studies, risk aversion due to stronger regulations does not lead to decreased profits.[114]

Shareholders Have Extra Power

One of the stronger arguments of shareholder primacy is the power granted to the shareholder to elect and/or dismiss directors and to approve by-laws and by-law changes. While this special power can be an indication that the rights and entitlement of shareholders are equitable in maximizing the wealth of an enterprise, it can be argued that the larger the corporation, the less power shareholders have. In smaller corporations, where one shareholder can own the majority of shares, that shareholder can alone can have virtually all the power of that small corporation. However, in larger corporations, due to the large scale and different shareholders, of different classes, it is much difficult to dismiss directors.[115] "Shareholders in public corporations generally

[114] Please see Guhan Subramanian, "The influence of antitakeover statutes on incorporation choice: evidence on the 'race' debate and antitakeover overreaching" (2002) 150.6 University of Pennsylvania Law Review 1795-1873; and Roberts Daines and Michael Klausner, "Do IPO charters maximize firm value? Antitakeover protection in IPOs." (2001) 17.1 Journal of Law, Economics, and Organization 83-120.

[115]Ben-Ishai, A Team Production Theory of Canadian Corporate Law, *supra note* 5 at 315; Stephanie Ben-Ishai, rightfully makes the argument in the Canadian context. She states "Shareholders of Canadian public corporations have the right to vote in relation to electing or removing directors and also in relation to certain 'fundamental' corporate changes. However, the right to vote has significant free rider, collective action, and rational apathy problems associated with it. With respect to electing the board, management will generally set the date for elections, nominate candidates, and use corporate funds to solicit proxy votes from shareholders. While shareholders who disagree with management's proposals for a board may obtain a list of shareholders, the shares they hold, and their addresses from the corporation so as to contact other shareholders for the purpose of influencing their voting, such action is rare. This is in part because, if a shareholder does solicit proxies, other than through a 'public broadcast,' from more than 16 shareholders, they must engage in the costly process of sending out a dissident's proxy circular." Similarly, a shareholder's right to vote on "fundamental" changes is also limited in reality. The types of changes that

can sue successfully in the firm's name only in situations where bringing suits benefits not only the shareholders, but other stakeholders in the 'coalition as well"[116] This reiterates the emphasis that is put on the interest of the corporation as a whole, rather than the shareholders themselves in spite of the shareholders holding that power. Other stakeholders do not have the power to elect directors, for allowing every stakeholder to have the right to dismiss directors will cause significant hardship on the management to run and manage the affairs of the corporation.[117] The argument for economic efficiency of fiduciary duty can be beneficial in this sense, where providing the power to dismiss directors is granted to only one instead of multiple stakeholders. Allowing multiple stakeholders to have such power will create certainty and unpredictability and will hinder management's ability to form decisions independent of the influence of each stakeholder and concerned with the best interest of the corporation.[118]

The Shift Away from Shareholder Primacy

"The end history of corporate governance is the norm of shareholder primacy."[119] Such declarations primarily, in the Anglo-American sphere, came in the late 1970s dominating the rest of the 20th century. This shareholder primacy triumph was further advocated by economists in the Chicago School of Economics. In Canada, the shareholder primacy model was dominant in the early 20th century.[120] Further research has also witnessed a parallel with the rise of

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are defined as "fundamental" are narrow. They include amendment of articles; amendment, repeal, or the introduction of new by-laws; amalgamation; and sale of substantially all the corporation's assets. In each case, without a shareholder proposal, all shareholders can do is agree or disagree with the question put to them by the directors.

[116] Blair & Stout, A Team Production Theory of Corporate Law, *supra* note 5 at 309.

[117] *Ibid*.

[118] Hart, *supra* note 74.

[119] Flannigan, *supra* note 39 at 40.

[120] *Can. Aero v O'Malley,* [1974] 1 SCR 592. Justice Laskin cites the work of Gower at Gower & Davies, *The Principles of Modern Company Law,* 518: "duties, except in so far as they depend on statutory provisions expressly limited to the directors, are not so restricted but apply equally to any officials of the company who are authorised to act on its behalf, and in particular to those acting in a managerial capacity." Justice Laskin then states "It follows that O'Malley and Zarzycki [senior executives] stood in a fiduciary relationship to Canaero [Corporation where both

globalization and the emphasis on shareholder primacy. With more development and the rise of multinational corporations (MNCs), shareholders emerged as the stronger class. Rightly so, shareholder primacy is a model that was appropriate for the milieu of the early 20th century. However, globalization also gave rise to the inter-multi-disciplinary interactions among the social, cultural, economic, and legal orders. The regulatory standards for labour law, environmental law, and human rights have all contributed to an interdisciplinary interaction with economics. As a result, if the sole purpose of a corporation is to maximize the wealth of shareholders, than that is contrary to the interdisciplinary order, where the economic considerations are intertwined with other orders mentioned above. The development of increased standards of regulation at the federal and provincial level has occurred as the courts have broadened the scope of the fiduciary duty as owed to more than one stakeholder. For example, oil and gas companies or transportation companies have higher standards of environmental care as legislated provincially and federally. Although fiduciary duty was not the source of protecting the environment, it now has fundamentally been broadened by legislation that requires that the directors take into account the environment.[121] In terms of employment standards, the contract

mentioned senior executives worked" While I will discuss common law cases in depth in Chapter 2, suffice it to say in *Canaero* the fiduciary duty has been viewed to be owed to the corporation. The interpretation of "best interest of the corporation" has been discussed by the federal government in drafts of the *CBCA. "Canada Business Corporations Act Discussion Paper: Directors Liabilities"* (November 1995), online: Canada Depository Services Program <http://dsp-psd.pwgsc.gc.ca/Collection/C2-280-7-1995E.pdf> at Part II (B), 14. "The Directors' Liability from Private Rights of Action Report concludes: "The concept of 'best interest of the company' is far from clear: does this merely mean maximizing value to shareholders or should the directors be considering other stakeholders? When the director himself or herself is another stakeholder (or has other interests), at what point are his or her decisions thereby tainted? The above issue could be left to be dealt with at common law." Further in their explanation, the report states "The concept of fiduciary obligations was developed over the centuries by courts of equity." Bruce Welling, *Corporate Law in Canada: The Governing Principles*, 2d ed (Toronto, Butterworths, 1991), 380. Further, the report states "of course, in Canada, the common law and equity courts have long been merged and the distinctions between the two bodies of laws have become less distinct. We will, therefore, continue to refer to common law development which should be taken to include the development under the law of equity."

[121] Please see Benjamin J Richardson, "Putting ethics into environmental law: Fiduciary duties for ethical investment." (2008) 46 Osgoode Hall LJ 243. The Supreme Court has, in previous judgments, has stated the following:

In *British Columbia v. Canadian Forest Products Ltd,* the Supreme Court of Canada states the following:

between the employee and the firm is not the only source of protection for the employee. For example, the *Employment Standard Act* (ESA) in Ontario requires the corporation to entitle employees to vacation days, sick leave, and maternity/paternity leave among other benefits. The executive branch of the corporation cannot violate the ESA; nor can they work against the spirit of the law to violate the interest of the employee.[122]

As argued, the shareholder primacy model is not a viable option for corporate governance, if maximizing the wealth of its shareholders is not aligned with the best interests of the corporation. However, maximizing the wealth of shareholders can be synchronized with long-term interest of the corporation with one major caveat: it must not be done at the expense of other stakeholders. Moreover, the 2008 financial crisis that began in the United States has also weakened the shareholder primacy model. The reasons are twofold. The first is that the impact of the economic crisis negatively affected other fabrics of society, which demonstrates the impact of one order on other orders.[123] This speaks to the interconnectedness and interdisciplinary society, similar to a domino effect. The low economic growth or economic decline led to job losses, which led to higher unemployment which led to higher crime rates. Statisticians, psychologists, sociologist, economists, should all work together to empirically assess the domino effect.

The question of compensation for environmental damage is of great importance. As the Court observed in *R. v. Hydro-Québec*, [1997] 3 S.C.R. 213, at para. 85, legal measures to protect the environment "relate to a public purpose of superordinate importance". In *Friends of the Oldman River Society v. Canada (Minister of Transport)*, [1992] 1 S.C.R. 3, the Court declared, at p. 16, that "[t]he protection of the environment has become one of the major challenges of our time." In *Ontario v. Canadian Pacific Ltd.*, [1995] 2 S.C.R. 1031, "stewardship of the natural environment" was described as a fundamental value (para. 55 (emphasis deleted)). Still more recently, in *114957 Canada Ltée (Spraytech, Société d'arrosage) v. Hudson (Town)*, [2001] 2 S.C.R. 241, 2001 SCC 40, the Court reiterated, at para. 1:

. . . our common future, that of every Canadian community, depends on a healthy environment. . . . This Court has recognized that "(e)veryone is aware that individually and collectively, we are responsible for preserving the natural environment . . . environmental protection [has] emerged as a fundamental value in Canadian society"

[122] Please see *Ontario Employment Standards Act*, SO 2000, c 41. The following sections are applicable: Sections 11-14, and 17-21.1.

[123] When I discuss orders, I am referring to the legal, cultural, social, economic, and political orders.

The second reason is the pressure on lawmakers to enact reforms. When large corporations become insolvent, such as Nortel Networks Corporation, mass employee layoffs create pressure for better regulation and legislation to protect employees' pensions and security.[124] As a result, political reforms are enacted by statutes, which require directors to ensure the interest of more than one stakeholder.[125] This shift impacts the fiduciary duty because it stretches it to become broader in its scope, and, as a result, the narrow interpretation would run counterintuitively to market forces. Whereas the market forces in the previous century would have one closed group of shareholders in closed corporations, this case is no longer viable, as larger corporations have different classes and groups of shareholders. The next section will assess and analyze in greater depth the fiduciary duty of the board of directors. This will include examining Section 122 of the *CBCA*, as well an analysis of the *BCE* case. First, an introduction will define and explain fiduciary duty, beginning with common law. The fiduciary duty owed by directors will be assessed, and examined as to why it is necessary to broaden the reading of the fiduciary duty to take into consideration the interests of multiple stakeholders.[126]

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[124] For further reading about the Nortel collapse please see Doug Hunter, *The bubble and the bear: How Nortel burst the Canadian dream* (Doubleday Canada, 2002)

[125]For example, Ontario. Regulation. 10/13: Nortel Pension Plans under *Pension Benefits Act, RSO 1990, c P.8* calls for compliances in ensuring employees interests are considered.

[126] One strategic decision that I have made in chapter two is to focus on team production theory instead of stakeholder theory. While both theories fundamentally propose that shareholders are not the only stakeholder of the corporation and focus on multiple stakeholders, there is a fundamental difference that made me choose and focus on team production theory. That reason can be found in the emphasis by team production theory on mediating hierarchy of the corporation. Directors must value the input of each stakeholder and doing so in practice will distinguish team production theory from stakeholder theory.

Stakeholder theory has been advanced by various scholars. Two leading scholars include Thomas Donaldson and Lee E. Preston, who co-authored the article, "The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications." Donaldson, Thomas, and Lee E. Preston, "The stakeholder theory of the corporation: Concepts, evidence, and implications." (1995) 20.1 Academy of management Review 65-91.The following statements sum up their differences from other theories.

"The stakeholder theory differs from these and other "theories of the firm" in fundamental ways. The stakeholder theory is intended both to explain and to guide the structure and operation of the established corporation. Toward that end it views the corporation as an organizational entity through which numerous and diverse participants accomplish multiple, and not always entirely congruent, purposes. The stakeholder theory is general and comprehensive, but it is not empty; it goes well beyond the descriptive observation that 'organizations have

Chapter 2:
Corporate Governance and Team Production Theory: The Evolution toward a Progressive, Pragmatic Interpretation of Fiduciary Duty

> A classical theory that once was unchallengeable must yield to the facts of modern life. In fact, of course, it has. If today the directors of a company were to consider the interests of its employees no one would argue that in doing so they were not acting *bona fide* in the interests of the company itself. Similarly, if the directors were to consider the consequences to the community of any policy that the company intended to pursue, and were deflected in their commitment to that policy as a result, it could not be said that they had not considered *bona fide* the interests of the shareholders.
>
> I appreciate that it would be a breach of their duty for directors to disregard entirely the interests of a company's shareholders in order to confer a benefit on its employees: *Parke v Daily News Ltd.* But if they observe a decent respect for other interests lying beyond those of the company's shareholders in the strict sense, that will not, in my view, leave directors open to the charge that they have failed in their fiduciary duty to the company.[127]

In the 1970s the Dickerson report, "Proposals for a New Business Corporations Law for Canada" proposed that the duty of care must be owed to the best interest of the corporation. The report states that the policy discussion and the interpretation of the directors' responsibility are best left

stakeholders.' Unfortunately, much of what passes for stakeholder theory in the literature is implicit rather than explicit, which is one reason why diverse and sometimes confusing uses of the stakeholder concept have not attracted more attention. The stakeholder theory can be, and has been, presented and used in a number of ways that are quite distinct and involve very different methodologies, types of evidence, and criteria of appraisal. Three types of uses are critical to our analysis. Descriptive/Empirical, Instrumental, Normative. Citing the American Law institute, emphasis on the normative dimension is essential: Observation suggests that corporate decisions are not infrequently made on the basis of ethical consideration even when doing so would not enhance corporate profit or shareholder gain. Such behavior is not only appropriate, but desirable. Corporate officials are not less morally obliged than any other citizens to take ethical considerations into account, and it would be unwise social policy to preclude them from doing so, the text does not impose a legal obligation to take ethical considerations into account. However, the absence of a legal obligation to follow ethical principles does not mean that corporate decision-makers are not subject to the same ethical considerations as other members of society. (American Law Institute, 1992: 80-82)"
It can be seen that emphasis on the descriptive, instrumental, and normative dimensions has driven stakeholder theory in its advancement to counter shareholder primacy. To reiterate, while team production theory has a similar objective, the practicality of focusing on mediating hierarchy and input by the employees, creditors, and suppliers has driven me to focus more on team production theory. This is not to say stakeholder theory has its limits or that it is not well developed. On the contrary, stakeholder theory has been advanced by multiple disciplines and presents a strong counter to shareholder primacy on a theoretical level. Team production theory shares the same objective as well. It is in their practicality that they might differ.

[127] *Peoples, supra* note 6 at para 42 citing *Teck Corp. v Millar,* [1972] 33 DLR (3d) 288. While the case of *Tech Corp v Millar* was decided in 1972, the concept of multiple stakeholders, as recipient of the fiduciary duty in Canada was fully confirmed in 2008 by the case of *BCE Inc. v 1976 Debentureholders*, 2008 SCC 69, [2008] 3 SCR 560.

for the judiciary to determine.[128] The SCC in *BCE*, beginning with *Peoples*, interpreted best interest of the corporation in the following statement:

> We accept as an accurate statement of law that in determining whether they are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, *inter alia*, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment.[129]

The impact of this decision effectively ended the shareholder primacy model that dominated the Canadian corporate governance landscape in the early twentieth century. While it was left for the judiciary to interpret fiduciary duty,[130] had the courts not had the chance to interpret the act, corporate governance would have been subject to many different laws affecting employees, consumers, and creditors. For example, increases in stronger labour laws, consumer laws, and creditors' law in bankruptcy and insolvency would have affected the fiduciary duty as owed by directors.[131] The power vacuum that would have been created due to absence of interpretation of fiduciary duty by the Supreme Court would have been filled by stronger federal and provincial legislations.[132] The shareholders of a corporation as residual claimants would not have been in a

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[128] Please see Dickerson, Robert W. V., John L. Howard and Leon Getz. *Proposals for a New Business Corporations Law for Canada*, online: vol. I. Ottawa: Information Canada, 1971 http://publications.gc.ca/collections/collection_2011/ic/RG35-1-1971-II-eng.pdf. Part 9.19 of the report. It is suggested that duty of care reads as its current legislation under paragraph a of s.122(1):
9.19 (1) Every director and officer of a corporation in exercising his powers and discharging his duties shall (a) act honestly and in good faith with a view to the best interests of the corporation. Please see Footnote 77 for more on the policy discussion around the position that the courts are best to deal with the interpretation of the "best interest of the corporation." It was stated that the courts are best able to fill in context around best interest of the corporation.
[129] *BCE, supra* note 6 at para 39; citing *Peoples*, *supra* note 6 at para 42.
[130] *Canada Business Corporations Act Discussion Paper: Directors Liabilities*, *supra* note 128.
[131] For example, *The Employment Standards Act, The Consumer Protection Act*, both provincial in Ontario, will allow for employees to ensure that directors take these into consideration. Moreover, the fiduciary duty as owed by directors to multiple stakeholders, mandated by the Common Law vis-à-vis the SCC decision in *BCE*, must be a work in collaboration and in spirit with legislations of the federal, and provincial governments. More importantly, it is to be in harmony and in the spirit of the law. While VanDuzer's claim is accurate, it is nuanced and technical. A broader view would demonstrate that the court's broader interpretation of the fiduciary duty would comply with other legislations, more specifically sections of the *CBCA*.
[132] The point is that fiduciary duty is one concept that complements other legislations. For example, strong labour laws can hold directors accountable to their employees. The fiduciary duty is then trumped by explicit legislation and statutes. The business judgment rule section will discuss the power that legislation has over equitable doctrine. Moreover, the oppression remedy allows certain stakeholders, i.e., shareholders, creditors, and security holders, to bring a claim of oppression remedy or derivative action. The discussion of the oppression remedy is beyond the scope of this thesis; however, it is vital to examine one point made by Stephane Rousseau. Please see Stephane

stronger position. As a result, the executive branch of the Canadian government has tasked the judiciary to best interpret the meaning of best interest of the corporation. The SCC in *Peoples* and reaffirmed in *BCE*, has reinterpreted and broadened the term to include multiple stakeholders. The next section will examine this shift and the evolution of the directors' fiduciary duty.

The Evolution of Fiduciary Duty

During the summer of 2008, the SCC had the opportunity to rule on and provide guidance on an operational level, i.e., to lay out what the fiduciary duties of directors are and to whom they are owed in the context of corporate management, as before them was the case of *BCE*.[133] Academic discussions of directors' fiduciary duty are abundant, with different scholars taking different sides, sides that either advocate for a narrow interpretation of fiduciary duty (shareholders only) or toward a more progressive, broader interpretation (different stakeholders such as employees, creditors, suppliers, consumers, and shareholders).[134] This definition is discernibly different from the low volume of judicial conversation on the topic. Lawyers, policy makers, corporations, and

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Rousseau, "Directors' Duty of Care after Peoples: Would it be Wise to Start Worrying about Liability?" (2005) 41 Can. Bus. L.J. at 227 says that directors who worry about liability and breach of fiduciary duty should only worry about the stakeholders that can bring claim under the oppression remedy. I find that problematic, as it runs counter to the spirit of the Supreme Court's decision in expanding the scope of fiduciary duty to multiple stakeholders including the suppliers, employees, the consumers alongside the shareholders, security holders, and creditors.

[133] *BCE, supra* note 6.

The Case was decided in June of 2008. However, the anticipation of the *BCE* case before the SCC was well documented leading up to June 2008 by corporate scholars, lawyers, groups, and individuals who were interested in the implications of the case. Major Canadian news outlets ran opinions and commentary prior to the case. Please see Jeffrey MacIntosh, "The *Peoples* Corporate Law: Unsafe at any Speed, "*The National Post (10* June 2008); retrieved from <http://www.law.utoronto.ca/news/article-macintosh-*Peoples*-corporate-law-unsafe-any-speed>; Allan C. Hutchison, "Why Shareholder Primacy?," *The Globe and Mail* (11 June 2008), online: The Globe and Mail <http://www.theglobeandmail.com/report-on-business/why-shareholder-primacy/article1056012/>.

The case effectively changed the legal landscape in Canada in terms of directors' duties, because the Supreme Court endorsed a multiple stakeholders' theory otherwise known as the "progressive theory of fiduciary duty." While the SCC started the change and endorsement of the progressive view of "fiduciary duty," the *BCE* cemented that view.. The progressive theory fiduciary duty has been discussed in depth in the Chapter 1.

[134] In the previous chapter, I discuss what is otherwise is known as "The Great Debate" in Corporate Law, the debate of shareholder primacy v. team production theory.

interested law firms are all stakeholders in this discussion, hoping that the SCC would clarify directors' duties.

The opportunity at the SCC was to decide on the scope of fiduciary duties and provide guidance to the stakeholders to allow for better corporate decision making and comfort in legal predictability and certainty. This would allow the management to make rational decisions that are consistent with clear legal standards.[135] Law and economics are two fields that have witnessed substantial discussion around defining their roles collectively, especially in regard to whether they interact or provide support to each other or are independent systems that do not coexist. Max Weber theorizes that the law gives rise to our capitalist economic system, allowing merchants, institutional and individual investors, and bankers to operate with comfort under certain and predictable laws.

The question with legal implications was to whom were fiduciary duties owed. In a unanimous ruling, the Supreme Court decided that the fiduciary duties of directors are owed to the best interest of the corporation. While the judgment by the court covered other core areas, the following quote sums up the decision of the SCC around fiduciary duty.[136] Chief Justice Beverley McLachlin stated:

> It is important to be clear that the directors owe their duty to the corporation, not to stakeholders, and that the reasonable expectation of stakeholders is simply that the directors act in the best interests of the corporation.[137]

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[135]As I have stated in the theoretical framework section, I rely on Max Weber's theory of legal rationality.
[136] Other areas discussed in the case were: Derivative Act - Oppression; Reasonable expectation for security holders of fair treatment; directors approving change of control transaction which would affect economic interests of security holders; whether evidence supported reasonable expectations asserted by security holders; whether reasonable expectation was violated by conduct found to be oppressive, unfairly prejudicial or that unfairly disregards a relevant interest.
[137] *BCE*, *supra* note 6 at para 66. The full paragraph reads as follows:
Directors, acting in the best interests of the corporation, may be obliged to consider the impact of their decisions on corporate stakeholders, such as the debentureholders in these appeals. This is what we mean when we speak of a director being required to act in the best interests of the corporation viewed as a good corporate citizen. However,

The SCC decision in *BCE* effectively completed the transformation of the theoretical foundation of fiduciary duty from a narrow to a broader interpretation. Jeffrey MacIntosh takes issues with the characterization of fiduciary duty owed to multiple stakeholders, stating:

> The corporation is effectively viewed as an abstraction divorced not only from the welfare of any individual constituency of shareholders, but from *all* constituencies taken together. The odd results is that, although the directors may 'consider' the interests of constituencies other than the shareholders, and not fall afoul of their fiduciary duties, these constituencies have no standing to complain if their interests are disregarded.[138]

He further states:

> How it is possible to simultaneously ignore individual constituencies and fix one's attention only on the corporation as an abstraction, while simultaneously paying scrupulous attention to the welfare of each and every individual constituency?[139]

When the courts state that the duties of directors are owed to the best interest of the corporation, it is not an abstraction divorced from the welfare of individual stakeholders; the best interest of the corporation includes taking into account the impact on each constituency. This is the evolution of fiduciary duty. Fiduciary duty has always been owed to the corporation, but it has traditionally meant that directors need only consider the interest of one stakeholder, the shareholders. However, this narrow interpretation has expanded to ensure other stakeholders' interests are taken into account.

While the theoretical foundation of a broad fiduciary duty will be discussed in depth, the evolution of fiduciary is aligned with the progress and development of the law. Stronger employment and labour legislation, stronger environmental protection, stronger creditor protection, and stronger consumer protection all point to interdisciplinary interaction that requires an overall awareness by companies to not violate legislation. Stronger legislation is

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the directors owe a fiduciary duty to the corporation, and only to the corporation. People sometimes speak in terms of directors owing a duty to both the corporation and to stakeholders. Usually this is harmless, since the reasonable expectations of the stakeholder in a particular outcome often coincide with what is in the best interests of the corporation. However, cases (such as these appeals) may arise where these interests do not coincide. In such cases, it is important to be clear that the directors owe their duty to the corporation, not to stakeholders, and that the reasonable expectation of stakeholders is simply that the directors act in the best interests of the corporation.[137]

[138] MacIntosh, *supra* note 53 at 52.

[139] *Ibid*.

needed in the areas of financial, environmental, occupational safety and public security laws. Societal shifts have broadened the fiduciary duty of directors to consider multiple stakeholders' interests, the employees, creditors, suppliers, consumers, and society at large. The SCC in its judgment did not call on directors to ignore individual constituencies and fix their attention on the corporation as an abstraction. On the contrary, the fiduciary duty as owed by directors to the corporation should be understood to include multiple stakeholders' interest.[140] The evolution that marked the shift in the fiduciary to be more progressive and broader is discussed by Norm Keith, where he highlights the increased accountability of corporations. He states:

> Public pressure to regulate corporations and their activities is demonstrated by government passing more statutes and more regulatory standards to respond to new technologies and evolving public expectations. This increased public expectation is heightened by fear of terrorism, workplace safety, pandemics, environmental disasters and capital market fraud and has increased public expectation that government needs to protect its citizens in the post-9/11 world.[141]

Calls for legislation to restrict fiduciary duties to only consider shareholders' interests is not only counter to the SCC's decision, it is counter to the notion of interconnectedness of the regulation between various social interests in society. It is contrary to increased workplace safety, and environmental and consumer regulations that have already been enacted by various statutes by the federal and provincial governments. For example, and more specifically, oil and gas corporations in bidding for the rights to drill on indigenous land in Northern Canada, with the potential for petroleum and mineral resources, must comply with criteria as set out by the government of Canada through the department of Indigenous and Northern Affairs Canada.[142] One criterion that corporations must meet is to draft and present a Benefit Plan.[143] This is

[140] *BCE*, *supra* note 6 at para 39.
[141] Norm Keith, "Evolution of Corporate Accountability: From Moral Panic to Corporate Social Responsibility" (2010) 11 Bus. L. Int'l at 254.
[142] I use the following example to demonstrate how legislation and fiduciary duties of corporate management are becoming more parallel.
[143] Benefit Plan under *Canada Oil and Gas Operations Act*, RSC 1985, c. O-7 ss. 5.2

required by legislation under subsection 5.2 (3) of the *Canada Oil and Gas Operations Act (COGOA).* It reads as follows:

> 5.2 (3): The Minister may require that any benefits plan submitted pursuant to subsection (2) include provisions to ensure that disadvantaged individuals or groups have access to training and employment opportunities and to enable such individuals or groups or corporations owned or cooperatives operated by them to participate in the supply of goods and services used in any proposed work or activity referred to in the benefits plan.[144]

The Benefit Plan requires corporations to invest in indigenous employees and businesses through providing employment, training, or education. Corporations are then required to spend their resources on a plan as one of the many criteria to win the license and rights to drill on indigenous lands in Northern Canada. This part of a required statute is not linked with the fiduciary duty of a corporation. However, if fiduciary duty as owed to the corporation is interpreted as considering shareholders' interests exclusively and it requires a board of directors to maximize the growth of shareholders only, it conflicts with existing legislation, such as subsection 5.2 (3) of *COGOA*. This conflict exists because the legislation requires the corporation to invest their resources on stakeholders and indigenous groups other than shareholders.

The counter-argument is that any corporation is required to invest and spend resources prior to witnessing growth. Therefore, investing resources in indigenous groups does not conflict with maximizing the wealth of shareholders, which would collect the profit on the projected growth *after* investing resources through a proposal of a Benefit Plan, especially considering that

[144] Ss. 5.2 (1) In this section, Benefit Plan means a plan for the employment of Canadians and for providing Canadian manufacturers, consultants, contractors and service companies with a full and fair opportunity to participate on a competitive basis in the supply of goods and services used in any proposed work or activity referred to in the plan.
Benefits plan:
(2) No approval of a development plan shall be granted under subsection 5.1(1) and no authorization of any work or activity shall be issued under paragraph 5(1)(b), until the Minister has approved, or waived the requirement of approval of, a benefits plan in respect of the work or activity.
Affirmative action programs:
(3) The Minister may require that any benefits plan submitted pursuant to subsection (2) include provisions to ensure that disadvantaged individuals or groups have access to training and employment opportunities and to enable such individuals or groups or corporations owned or cooperatives operated by them to participate in the supply of goods and services used in any proposed work or activity referred to in the Benefits Plan.

the plan does not start until after a corporation wins the rights and license to drill for natural resources. While the posed counter-argument is accurate, the point is the fiduciary duty must not exclusively be concentrated on shareholders. If shareholders were the main concern of corporate management, then there would be a two-tier system, where fiduciary duty as owed to the corporation only considered the interests of the shareholders versus legislations that impose statutory duties on directors to consider multiple stakeholders' interest. Moreover, if shareholders collected the profit on the projected growth after the corporation invested its resources, this would run counter to maximizing the wealth of shareholders. In order to maintain the project, the corporation must spend more of its resources on disadvantaged individuals, thus the projected profit after the investment must not all go to shareholders, as some of the profit needs to be redirected in continued investment on disadvantaged individuals. The fiduciary duty must have the same spirit as other legislation, in that the directors of the corporations must take into account the interest of stakeholders. A narrow conception of the fiduciary duty owed to the corporation, which only considers shareholders' interests, will contrast with legislation that requires corporations to take into account the interest of multiple stakeholders. As a result, the interpretation of the fiduciary duty by the judiciary to mean it is owed to the corporation and not exclusively to a single stakeholder is a very sound principle. What is lacking is the transformation of the principle into practical guidance for the management of the corporations. How, in practical terms, can the expanded scope of the fiduciary duty be shifted from principle to practice? Examining previous Supreme Court and Appellate Court cases will help to establish this framework.

Can. Aero v. O'Malley

In 1973, more than a decade after *Parke v. Daily News Ltd*.,[145] the SCC heard the case of *Canaero v. O'Malley* (1974) (hereinafter Canaero).[146] The issue of this case was whether or not the directors of Terra Surveys Limited, O'Malley and Zarzycki, breached their fiduciary duty to their former employer, Canadian Aero Service Limited.[147] The issue of whether the directors of a corporation breached their duty is critical, because it concerns a fiduciary duty owed to a corporation. This case has contributed in furthering the quest to define to whom duties are owed within a corporation [148]

The issue before the SCC was whether the directors were liable for breaches of fiduciary duties owed to Canaero. More specifically, to what extent does a senior executive or official owe a fiduciary duty to the corporation they represent, and do the actions taken by defendants

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[145] It is important to note that the highest appeal court in Canada, up until 1949 was the Privy Council in the United Kingdom. Post-1949, the top court in Canada was the Supreme Court of Canada (SCC). However, British influence in Canadian corporate law was dominant. *Parke v. Daily News Ltd*. was decided in 1962 in the UK. The influence of the case was still lingering in Canada. Can. Aero v O'Malley was decided by the Supreme Court of Canada in 1974, and it was the first case by the SCC to mark a shift from not recognizing shareholders as the sole stakeholder.

[146] *Can. Aero v O'Malley,* [1974] 1 SCR 592. [*Can. Aero*]

[147] *Ibid*.

[148] Canaero was a wholly-owned subsidiary of Aero Services Corporation until Litton Industries Inc. bought them out in 1961. At that time, O'Malley was the president and chief executive officer (CEO) of Canaero; after his resignation from Canaero on August 19, O'Malley became president of Terra; shortly after, Zarzycki also resigned at both of his posts at Canaero and became executive vice president of Terra.

Canaero and Terra provided similar services, such as topographical mapping. This case centres on the Guyana Project. The project entailed mapping and conducting aerial photographs of Guyana (the mapping was done for mining exploration). The project was financed by the government of Canada through the Department of External Affairs Canada, currently known as the Department of Global Affairs Canada, as part of its programme to provide aid to developing countries. Canaero's interest in this project began as early as 1961 and was led by both O'Malley and Zarzycki. Due to political upheaval in Guyana, Canaero suspended all of its activities, but they resumed in 1965 after stability increased in Guyana. On August 23, 1966, the Department of External Affairs issued a notice for a request of proposal (RFP). Both Canaero and Terra submitted their bid, and ultimately, Terra won the rights to the project on September 16, 1966. It is important to note that a Canadian government official recommended that Terra be awarded the contract, stating," [Terra's] proposal indicates that its authors [O'Malley and Zarzycki] have studied the subject very thoroughly and in preparing their plan of operation have also taken conditions peculiar to Guyana into account." Zarzycki was vice president, and he was eventually named director in 1965. Both O'Malley and Zarzycki were dissatisfied because they were micromanaged by the parent company, Litton Industries. Terra Surveys Limited (hereinafter Terra) was incorporated on August 16, 1966.

constitute a breach of that duty? The SCC found that a breach of fiduciary duty had occurred. Justice Laskin provided the following explanations:

> The reaping of a profit by a person at a company's expense while a director thereof is, of course, an adequate ground upon which to hold the director accountable.…What these decisions indicate is an updating of the equitable principle whose roots lie in the general standards that I have already mentioned, namely, loyalty, good faith, and avoidance of a conflict of duty and self-interest…. Strict application against directors and senior management officials is simply recognition of the degree of control which their positions give them in corporate operations.… [it is] a necessary supplement, in the public interest, of statutory regulation and accountability…. [and as an] acknowledgement of the importance of the corporation in the life of the community and of the need to compel obedience by it and its promoters [the corporation], directors and managers to norms of exemplary behaviour.[149]

Justice Laskin stated, "Strict application against directors and senior management officials is simply recognition of the degree of control which their positions give them in corporate operation."[150] Of vital importance is Justice Laskin's recognition that the directors had complete management control; thus, there was a strict application in the public interest community. The community is comprised not only of shareholders but also employers, consumers, and creditors. This case acknowledged a marked turn to a broader definition of corporate interest that included the stakeholders. By broadening the responsibility of fiduciary duty the Canadian judiciary affirmed that an interdisciplinary approach where directors reap benefits to the detriment of the corporation is not only a loss to the shareholder, but also to the community. The judiciary rightfully acknowledged this fact.

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[149] *Can. Aero*, *supra* note 147, para. 384. O'Malley and Zarzycki reaped a profit at the expense of their former company, Canaero. All of their knowledge about Guyana was mainly gained through their senior positions at Canaero, but Canaero did not benefit from their knowledge because Terra ultimately won the bid for the contract.
[150] *Ibid*.
Canaero spent its resources in an effort to secure the contract; their resources included employee labour, such as gathering essential information to win the bid, which was set out in the requirements for the RFP. Moreover, Zarzycki traveled to Guyana, but not at his own expense; rather, it was considered a business trip. O'Malley and Zarzycki had reassured Canaero that it was a worthwhile project on which to spend resources. The shareholders who invested in the corporation were not the only ones with tangible losses. Dedicating employees to the projects took time away from their work on other projects, as much of their time and dedication was spent acquiring the rights to the contract. Therefore, because Canaero had not won the project, the expertise its employees built into bidding for the project was lost as well. A loss to a corporation impacts the shareholders as well as the employees.

820099 Ontario Inc. v. Harold E. Ballard Ltd.

The case of *820099 Ontario Inc. v. Harold E. Ballard Ltd*. [*Ballard]*[151] continued the shift away from the interest of shareholders to the interest of multiple stakeholders. The issue before the court was whether the directors breached their fiduciary duty.[152] The court agreed and reasoned that directors must consider the best interests of Ballard Ltd. as a corporation, not the best interests of the controlling shareholder, Mr. Ballard. Justice Farley stated,

> It would be inappropriate for that director (or directors) to only consider the interests of certain shareholders and to either ignore the others or worse still to act in a way detrimental to their interests. The safe way to avoid this problem is to have the directors act in the best interests of the corporation (and have the shareholders derive their benefit from a 'better' corporation)...It may well be that the corporate life of a nominee director who votes against the interest of his 'appointing' shareholder will be neither happy nor long. However, the role that any director must play (whether or not a nominee director) is that he must act in the best interests of the corporation.[153]

One of the most critical statements by Justice Farley states that shareholders derive their benefit from a "better corporation" instead of placing shareholders at the primacy of the corporation.[154] This is not necessarily relegation of shareholders in favour of other stakeholders, but rather a continuation of the shift away from shareholder primacy, i.e., the best interest of the corporation does not mean the best interest of the controlling shareholders. Shareholders will benefit from a better corporation, and the best interest of the corporation includes consideration of multiple stakeholders.

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[151] *820099 Ontario Inc. v Harold E. Ballard Ltd.,* [1991) 3 BLR (2d) 113.

[152] *Ibid.* Mr. Ballard controlled Ballard Ltd., a private corporation that controlled 20% of Maple Leaf Gardens Ltd. (MLG), a public corporation. Mr. Ballard set up a trust and transferred all common shares equally to his three children but maintained control over the preferred shares. After a falling out with all of his children he decided to regain control of MLG. Another party from Montreal was interested in obtaining control of MLG; however, Mr. Ballard objected. Mr. Ballard ultimately controlled Ballard Ltd. and the board of directors, and he managed to buy out two of his three children. The third child was a minority shareholder in MLG and brought a claim for oppression against the board of directors, claiming that the directors unfairly regarded his interest and disagreed with him on account of Mr. Ballard's wishes.

[153] *Ibid*.

[154] *Ibid*.

When competing interests exist among stakeholders, to whom do directors owe fiduciary duty? Competing interests do not usually occur in the day-to-day management of the corporation in decision making; it is in special circumstances that competing interests are heightened. Throughout the thesis it has been argued that the fiduciary duties of directors are owed to maximize the value of the corporation. This is the normative objective of the corporation. This maximization of value is to benefit the shareholders, the creditors, and the employees among other stakeholders. Maximization of value is not owed exclusively to the shareholders. While this was the end goal of the corporation in the early 20th century, it cannot be said to exist today. The shareholders of a corporation cannot have their wealth maximized without the interests of all stakeholders taken into consideration. As the Dickerson report stated, the best interest of the corporation should be left to the interpretation of the judiciary.[155] The SCC has been explicit in acknowledging this shift from the shareholder primacy model to a model that benefits all affected stakeholders. The next two cases, decided by the SCC, demonstrate and cement this shift toward a broader interpretation, one that favours the consideration of multiple stakeholders.

Peoples Department Stores Inc. (Trustee of) v. Wise (hereinafter Peoples)

Wise, a clothing store, was founded by Alex Wise and was controlled by Mr. Wise's three sons, who were the only shareholders, officers, and directors of the company.[156] The brothers purchased another corporation, Peoples Inc., a department store, for $27 million dollars. It was an unincorporated division of Marks & Spencer Canada Inc. (Marks & Spencer).[157] Wise's three children, the defendants in this case, ultimately merged the newly created company 2798832

[155] Dickerson, *supra* note 128.
[156] *Peoples, supra* note 6 at para 4.
[157] *Ibid* at para 9.

Canada Inc.[158] At the SCC, the issue was: Did the directors of Wise owe a fiduciary duty to the creditors of Peoples. The majority of the Supreme Court decided that the answer was no; there was no need to extend the directors' statutory fiduciary duty under Section 122(1)[159] to creditors because they have other available remedies under the statutes of *CBCA,* such as derivative action or an oppression remedy. The Supreme Court stated the following:

> The directors' fiduciary duty does not change when a corporation is in the nebulous "vicinity of insolvency"...What it is obviously intended to convey is a deterioration in the corporation's financial stability. In assessing the actions of directors it is evident that any honest and good faith attempt to redress the corporation's financial problems will, if successful, both retain value for shareholders and improve the position of creditors. If unsuccessful, it will not qualify as a breach of the statutory fiduciary duty.[160]

In the following paragraph, the majority of Supreme Court justice delivered the following:

> In resolving these competing interests, it is incumbent upon directors to act honestly and in good faith with a view to best interest of the corporations. In using their skills for the benefit of the corporation when it is in troubled financially, the directors must be careful to attempt to act in the best interest by 'creating a better corporation and not to favour the interests of any one group of stakeholders. If the stakeholders cannot avail themselves of the statutory Fiduciary Duty to sue the directors for failing to take care of their interests they have other means at their disposal. [161]

The SCC, as stated in *Peoples*, claimed that duties were still owed to the corporation.[162] The duties were not shifted to be owed exclusively to the shareholders or the creditors or, in fact, to any single stakeholder. The duties were found to be intact and owed in the best interest of the corporation. This is a sound principle as it allows the directors to do the following:

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[158] More facts about *Peoples*: For the purpose of acquiring all of the issued and outstanding shares of Peoples from Marks & Spencer and Peoples, and retaining the name Peoples, Marks & Spencer agreed but objected to a new inventory procurement policy. The inventory purchased by both companies, anything purchased abroad, would be purchased by Peoples, but domestically it would be purchased by Wise. Peoples had greater purchases over time. After procurement challenges, both corporations, Wise and Peoples*,* filed for bankruptcy in 1994, Marks & Spencer accused Wise that the inventory procurement policy was financial assistance to Wise Stores in breach of the terms of their agreement during time of finalizing the purchase. As a result Marks & Spencer alleged that Wise had favoured the interests of Wise over Peoples to the detriment of Peoples' creditors (Marks & Spencer), in breach of s. 122(1) of the *CBCA*. It is also vital to note that no claim of oppression remedy has been brought by Marks & Spencer against Wise. Marks & Spencer sued for the amount not paid by Wise to Peoples, alleging that the directors of Wise had a reckless disregard for the interest of Peoples' creditors.

[159] *CBCA* and *OBCA*, *supra* note 2 Sections 122(1) and 134(1) respectively.

[160] *Peoples*, *supra* note 6 at para 39.

[161] *Ibid*.

[162] *Ibid*.

1) It allows the directors to not be held captive by one particular stakeholder group during management decision making.

2) In regard to the duties owed to the corporation during the time of insolvency the management acting in good faith will make business decisions that might be detrimental to certain stakeholders while beneficial to other stakeholders. This provides the corporate management with certainty and predictability of knowing that the business decision cannot be challenged and accepted by the courts so long as those decisions can be made with the objective of the best interest of the corporation.

While those principles are sound, the uncertainty and criticism directed at the Supreme Court for their ruling was due to a practical framework guide to transition those principles in practice not provided by the SCC.[163] The principle of ensuring the best interest of the corporation is not limited to the short-term interest of one stakeholder, but rather it is the long-term interest of the corporation that must be at the forefront when deciding between competing interests of multiple stakeholders. Edward Iacobucci provides the following example, which clarifies such points. Iacobucci stated:

> Suppose an action [of the corporate management] benefits the shareholders by $10, but costs creditors $15. When shareholders borrow, if their duties permit (or indeed compel) directors to take this action in the future, creditors will require compensation for anticipated losses after the debt has been issued. In an efficient market, lenders would insist on rates that would compensate them for the future loss of $15; abstracting from risk and the time value of money for simplicity, they would demand an extra $15. Shareholders' residual claim would fall in expected value by $15 in order to realize gains of $10.

As seen, short-term gain for the shareholders will be possible; however, the focus and the principles endorsed by the Supreme Court is to maximize the value of what is in the best interest of the corporation, in practice, will be judged by the long-term sustainability and growth of the corporation. If the board of directors in their business decisions engage in excessive risky

[163] ---- *supra*, note 53.

behaviour, the courts are allowed to intervene. Iacobucci[164] states that "the choice of excessively safe or risky investment is the one area in which there is shareholder-creditor conflict, but such decisions are effectively not subject to review"[165] While it is generally accepted that the business decisions are not subject to review, it is critical to note that there are exceptions where the courts will intervene.[166] It would be contrary to the Supreme Court's decision to excessively state that safe or risky investments are effectively not subject to review. Risky investments that are contrary to the best interest of the corporation are subject to review.

Creditors as Stakeholders

Creditors are important stakeholders and their relationship with the corporation is an arm's length commercial association.[167] Creditors' relationships with a corporation will vary depending on the context and the maturity stage of the corporation. Even though a corporation near insolvency might put creditors in a position of vulnerability, the SCC has ruled that the management does not owe a specific fiduciary duty to the creditors in such cases.[168] The fiduciary duty of the management is owed to the corporation.[169] The inference or the interpretation from the Supreme Court's decision is that while the fiduciary duty is owed to the corporation; this may incorporate the interest of the creditors if their interest aligns with the best

[164] Edward Iacobucci, "Directors' Duties in Insolvency: Clarifying What is at Stake" (2003) 39 Canadian Business Law Journal 398-411.
[165] *Ibid* at 405.
[166] The following chapter in examining the business judgment rule will discuss in depth the circumstances where the courts intervened.
[167] The reason why the duty of care is owed to shareholders rather than creditors cannot rest on substantive arguments about appropriate incentives to maximize value, since there is no shareholder/creditor conflict over questions of waste that the duty of care engages in practice. See especially Edward Iacobucci, Directors' Duties in Insolvency*, supra* note 164. Also, *Lac Minerals, supra* note 3; Justice LaForest states, "On the other hand, there are relationships which are not in their essence fiduciary, such as the relationship brought into being by the parties in the present case by virtue of their arm's length negotiations toward a joint venture agreement, but this does not preclude a fiduciary duty from arising out of specific conduct engaged in by them or either of them within the confines of the relationship.
[168] *Peoples*, *supra* note 6 at para 46.
[169] *Ibid* at para 39.

interests of the corporation. As a result, this concurrence will enable creditors to be included within the scope of the fiduciary duty as owed by the management of the corporation. Otherwise, the current law in Canada is that the management does not owe an exclusive fiduciary duty to creditors of a corporation or to any other stakeholder exclusively.[170]

Insolvency and Risky Investments

When a corporation is insolvent, the management must comply with the *Bankruptcy and Insolvency Act* (BIA).[171] Graham King notes that the creditors may require the corporation to restructure its operation or to divest certain assets to generate additional cash, under either a private agreement or under the restructuring provisions of the BIA.[172]

The trial judge in *Peoples,* Justice Greenberg, ruled that there is a duty that must be owed to creditors near insolvency.[173] In his judgment Greenberg J relied on the work of Jacob Ziegel when he stated, "British, Australian and New Zealand courts have repeatedly held, at least where a company is insolvent or near to insolvency, that the directors' duties lie not only toward the company's shareholders, but that they are also bound to act in the best interests of the company's creditors"[174]

However, the SCC disagreed with the trial judge. If a corporation is near insolvency, the fiduciary duty of the directors will not shift to a certain stakeholder; it remains to be owed to the corporation. The SCC has stated the following:

> The various shifts in interests that naturally occur as a corporation's fortunes rise and fall do not, however, affect the content of the fiduciary duty under s. 122(1)(a) of the *CBCA*. At all times, directors and officers

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[170] *Ibid.*
[171] *Bankruptcy and Insolvency Act,* RSC 1985, c B-3.
[172] C. Graham W. King, "Extending Fiduciary Principles to the Director-Creditor Relationship: A Canadian Perspective" (2002) 29 Man. L.J. at 249.
[173] *Peoples*, *supra* note 6 at para 27.
[174] Ziegel, *supra* note 28 at 529 - 530.

> owe their fiduciary obligation to the corporation. The interests of the corporation are not to be confused with the interests of the creditors or those of any other stakeholders.[175]

This allows directors who understand the business dynamic of the corporation to operate in a framework where the interest of the corporation will be at the forefront in their decision making. By extension of such principle, long-term gain of the corporation will ensure the interested stakeholders' interests have received the best deal possible. Corporate management who ostensibly believe the short-term gain of a particular shareholder is in the best interest of the corporation will not be granted deference under the business judgment rule, and, thus, the management can be in breach of its fiduciary duty. It is this extension of acting in the best interest of the corporation and maximizing the wealth of the corporate value, where creditors and shareholders can find solace that their interests will not be blatantly disregarded.

BCE v. 1976 Debentureholders

Two primary issues were presented before the SCC. The first was whether the defendants (the board of directors of BCE Inc.) breached their fiduciary duty. The second was whether the approval of the arrangement was oppressive to the debentureholders.[176] The SCC decided that no

[175] *Peoples*, *supra* note 6 at para 43.

[176] Bell Canada is a wholly owned subsidiary of Bell Canada Enterprises (hereinafter BCE Inc.). Bell Canada issued debentures to investors in 1976, 1996, and 1997. The board of directors had three different offers to buy out BCE *Inc.*. Under each offer, BCE's debt would increase significantly, thus affecting the value of the debentureholders' trust indentures. Ultimately, the board of directors decided that an arrangement by a group led by the Ontario Teachers' Pension Plan Board (teachers) would be in the best interest of the corporation and would enhance the share values for shareholders by 40%. The final arrangement was that Bell Canada would guarantee 30 billion dollars of BCE Inc's. new debt. The consortium led by teachers would spend $80 billion to acquire BCE Inc. At a general shareholder meeting, the deal was put to a vote and approved by 97% of shareholders.[176] However, the debentureholders complained that their interest had been compromised by the transactions. This is due to the debentureholders becoming vulnerable through the acquisition of extra debt, meaning the value of their indentures would decrease and the shareholders' share values would increase. The debentureholders claimed that the board of directors had unfairly disregarded their interests, as the deal would be oppressive to them. The Quebec Superior Court dismissed the debentureholders' claim, but the Quebec Court of Appeals allowed their appeal, stating that the board of directors of BCE Inc. had to consider the debentureholders' interests and that they had created expectations beyond contractual rights. This meant that the BCE Inc.'s board of directors owed fiduciary duty to the debentureholders, and thus, not taking their interests into account had constituted a breach. BCE Inc. then appealed to the SCC.
Ibid at para 30. The Supreme Court articulated the issues as follows:

breach of fiduciary duty had occurred and the approval of the arrangement was not oppressive to the debentureholders. As a result, the appeal was allowed, thus overturning the Quebec Court of Appeals' decision.[177]

Prior to discussing the Supreme Court's judgment, it is important to note that all three deals to buy out BCE Inc. would have decreased the value of the debentureholders' investment.[178] As a result, the board of directors approved teachers to lead in the acquisition of all of BCE's shares. This arrangement was court-approved under Section 192 of the *CBCA.* The board of directors selected from the three deals, the one they believed would be in the best interest of the corporation. However, in December of 2008, the whole deal fell apart, never to reach completion.[179] The court's decision was historical in that it affected the corporate legal landscape in Canada; more specifically, the conduct of corporation directors changed, and moving forward, directors of any corporation must be cognizant of the Supreme Court's decision concerning *BCE* when engaged in decision making that has the potential to affect multiple stakeholders of a corporation.

The Decision

The SCC analyzed in depth the fiduciary duty owed to the corporation. Citing its decision in *Peoples*, the SCC stated,

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- whether the Court of Appeals erred in dismissing the debentureholders' s. 241 oppression claim and in overturning the Superior Court's s. 192 approval of the plan of arrangement.
- issue of what is required to establish oppression of debentureholders in a situation where a corporation is facing a change of control, and how a judge on an application for approval of an arrangement under s. 192 of the *CBCA* should treat claims such as those of the debentureholders in these actions.

[177] *Ibid* at para 168.
[178] *BCE*, *supra* note 6 at para 99.
[179] The whole deal fell apart because in the takeover there was a provision that the liquidity of Bell Canada would not be adversely affected. Auditor Firm KPMG determined that a required test for the solvency was not met and, thus, not satisfied. The conclusion was that the liquidity of Bell Canada would be adversely affected. For further reading on the aftermath of the deal please see *Canadian Press (11* December 2008), online: CBC News, retrieved from < http://www.cbc.ca/news/business/*BCE*-takeover-deal-dead-as-fight-looms-over-1-2b-breakup-fee-1.705382>

> "The fiduciary duty of the directors to the corporation originated in the common law. It is a duty to act in the best interests of the corporation. Often the interests of shareholders and stakeholders are co-extensive with the interests of the corporation. But if they conflict, the directors' duty is clear — it is to the corporation."[180]

The SCC then determined what would occur if stakeholders' interests conflicted:

> "The fiduciary duty of the directors to the corporation is a broad, contextual concept. It is not confined to short-term profit or share value. Where the corporation is an ongoing concern, it looks to the long-term interests of the corporation.[181]

Citing *Peoples*, once again, the SCC stated that the directors must consider the best interests of the corporation. The court also determined that it may be appropriate, *although not mandatory*, to consider the impact of corporate decisions on shareholders or particular groups of stakeholders.[182] How will directors then deal with conflicting interests? The Supreme Court did not develop a direct test that will enable directors to determine if they have appropriately dealt with conflicting interests. The SCC stated,

> In considering what is in the best interests of the corporation, directors may look to the interests of, inter alia, shareholders, employees, creditors, consumers, governments and the environment to inform their decisions. Courts should give appropriate deference to the business judgment of directors who take into account these ancillary interests, as reflected by the business judgment rule.[183]

In not developing a direct test for directors to solve conflicting interests, the SCC created a fundamental benchmark criteria that the best interest of the corporation be the determinant in mediating the competing interests of stakeholders. While this will be the major requirement, the SCC has given deference to the directors via the business judgment rule (hereinafter BJR).[184]

What is arguably one of the most important statements in the decision is the court's acknowledgement that short-term profit or share value will not be the primary duty of boards of directors. This marks the fundamental shift that was established in *Peoples* that the maximization of shareholders' wealth will not be the sole objective of directors, while this objective was seen

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[180] *BCE*, *supra* note 6 at para 37.
[181] *Ibid* at para 38.
[182] *Ibid* at para 38-39.
[183] *Ibid* at para 40.
[184] Chapter 3 will focus heavily on the business judgment rule (BJR).

in earlier cases in common law.[185] According to the SCC in 2004 and again in 2008, the fiduciary duty is owed to the best interest of the corporation and, thus, may be owed to multiple stakeholders, so long as their interests synchronize with the interests of the corporation. In this case, the shareholders in *BCE* gained value in their shares while the debentureholders did not. The board of directors had three offers that would all have ultimately decreased the debentures value, and for the debentureholders that would be a loss. Faced with choosing one of the three options, the directors ultimately believed their choice was in the best interest of the corporation. The best interest of the corporation was beneficial to the shareholders, as it gave them a premium increase in their share value. The shareholders did not benefit solely because of the narrow interpretation of the fiduciary duty. Rather, their benefit was due to their interest being aligned with the best interest of the corporation, not that shareholder primacy is always in the best interest of the corporation.

A fundamental element of the best interest of the corporation is that it will always be superior to individual stakeholders' interests, although it is important to note that the collective interest of all stakeholders is ultimately the best interest of the corporation. Uncertainty may arise from this claim, and as a result, further clarification will simply mean that the board of directors will always strive toward the best interest of the corporation. The wealth enhancement of the corporation will also benefit shareholders, employees, or multiple stakeholders. As a result, multiple stakeholders will benefit due to the corporation's overall benefit. Otherwise, the benefit of the corporation might be detrimental to one stakeholder. In this case, the benefit of the corporation and the gain to the shareholder came at the expense of the debentureholders.

[185] *Parke*, *supra* note 8.

Due to the SCC expanding the definition of fiduciary duty, there can be multiple beneficiaries of the duty. The question, thus, becomes who is able to claim a breach of fiduciary duty.[186] The SCC addresses this question by stating,

> Normally only the beneficiary of a fiduciary duty can enforce the duty. In the corporate context, however, this may offer little comfort. The directors who control the corporation are unlikely to bring an action against themselves for breach of their own fiduciary duty. The shareholders cannot act in the stead of the corporation; their only power is the right to oversee the conduct of the directors by way of votes at shareholder assemblies. Other stakeholders may not even have that.[187]

The shareholders have the power to bring a claim under derivative action but that does not mean they act in the stead of the corporation for every claim against the corporation. Is it then contradictory for the shareholders to oversee the directors by way of votes? The reason for one stakeholder to be granted this power can be uncovered by examining the economics of corporate efficiency.[188] Granting the right of overseeing the directors' conduct by way of votes to employees, creditors, and shareholders can cause serious damage to the corporation. Such a policy would create uncertainty for the directors, who might in every decision be beholden to stakeholders. It would also lead to uncertainty because the directors would not know in advance what the interests of the various stakeholders might be. Therefore, granting the shareholders this right creates predictability and certainty in acknowledging that the directors are able to make decisions with the comfort that only one stakeholder might vote them out.

With this logical rationale for granting the shareholders this right, the question arises as to whether the fiduciary duty should be expanded to multiple stakeholders or solely to the

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[186] Notably absent from this discussion is the oppression remedy. It is vital to note oppression remedy is an available means within the statutory legislation of *CBCA*. Under *Canada Business Corporations Act,* RSC 1985, c. C.44 S. 241, specific stakeholders, such as security holders, creditors, directors or officers of the court may make an order to rectify complaints.

[187] *BCE*, *supra* note 6 at para 41.

[188] Blair & Stout, A Team Production Theory of Corporate Law, *supra* note 5 at 311.

shareholders.[189] The logical rationale of granting the shareholders the right to vote cannot be extended or applied to the beneficiaries of the fiduciary duty, because each stakeholder must look after his or her own interests. Therefore, the shareholders are not the only stakeholders who must claim breaches of fiduciary duty. While it is best for the shareholder to be granted the power to vote, it is not logical for the shareholder to also be responsible to ensure other stakeholders' interests are taken into consideration. That must be left up to each stakeholder to ensure, and shareholders must not have this extra responsibility.

The court then continues its ruling by stating who is able to bring a relief or claim of breach of fiduciary duty against the corporation. The SCC states, "The first remedy provided by the *CBCA* is the s. 239 derivative action, which allows stakeholders to enforce the directors' duty to the corporation when the directors are themselves unwilling to do so."[190] Moreover, on the oppression remedy[191], the SCC states:

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[189] This is the broad, underlying crux question that this thesis establishes to answer. While the question is general, it can also be specific. I attempt to answer it in its specific context in this situation.

[190] The full paragraph, 41, reads as follows: [43] The first remedy provided by the *CBCA* is the s. 239 derivative action, which allows stakeholders to enforce the directors' duty to the corporation when the directors are themselves unwilling to do so. With leave of the court, a complainant may bring (or intervene in) a derivative action in the name and on behalf of the corporation or one of its subsidiaries to enforce a right of the corporation, including the rights correlative with the directors' duties to the corporation. (The requirement of leave serves to prevent frivolous and vexatious actions, and other actions which, while possibly brought in good faith, are not in the interest of the corporation to litigate.)

[191] Notably absent in this thesis is the oppression remedy. To be granted oppression remedial relief under common law, the alleged act must prove to be "burdensome, harsh, and wrongful." Under the statutory provisions, the oppression remedy focus shifted to acts that are "oppressive" or ones that are "unfairly prejudicial to or unfairly disregard the interests of certain parties." Please see R.L Campbell ed, *Accountability of Corporate Management* (Concord Ontario: Captus Press Inc, 2013) at 308.

Effectively, under section 241 of the *CBCA*, the oppression remedy became broader than the strict interpretation under common law. Any security holder, creditor, director or officer, and any other person that a court decides is a "proper person to make an application" may seek relief from actions of a corporation or its directors that are "oppressive or unfairly prejudicial to or that unfairly disregard their interests." [Potentially, employees may fall under the "proper person to make an application;" that will be up to the courts to decide. Stakeholders that are recipient of fiduciary duty other the creditors and security holders, may fall under that category.]

It has been argued that for their fiduciary duty, directors should only focus on the stakeholders that are able to bring a claim under the oppression remedy. This means that because employees, consumers and the suppliers, have not been explicitly classified as complainants, directors need not focus on them, but rather the focus should be primarily on security holders and creditors. This argument goes against the spirit of the court's ruling in *BCE* to extend the

> The oppression remedy provision in the *CBCA* precludes most claims by nonshareholder stakeholders, other than creditors. In an oppression claim, the complainant must establish that 'the interests of any security holder, creditor, director or officer' have been oppressed, unfairly prejudiced or unfairly disregarded. The language of the provision simply does not permit other [stakeholders other than the shareholders or creditors] interests to be considered.[192]

As a result, the argument is that the stakeholders who are able to bring a claim of oppression remedy are inconsistent with the SCC's vision for fiduciary duty to serve multiple stakeholders; moreover, VanDuzer claims that the *CBCA* is also inconsistent with the court's broad interpretation of fiduciary duty, as the ground of relief defined under *CBCA* s.249 have not benefitted stakeholders other than shareholders, creditors, and security holders.[193] While the point is legitimate and accurate, it is narrow in scope and does not take into consideration that employees and consumers are also protected by legislation that will ensure their rights be honored by board of directors.[194]

The next section will examine the theoretical aspects of the broader fiduciary duty to consider the interests of multiple stakeholders in the team production model of corporation

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fiduciary duty beyond shareholders. Engaging and discussing the oppression remedy is outside the scope of this thesis, however, for future research it would be beneficial to explore the phrase "proper person to make an application" in the legislation under oppression remedy, and assess those stakeholders of the fiduciary duty that can be classified as such. In conducting research for the oppression remedy, it has been determined under 122.(1) (b) of the *CBCA*, that fiduciary duty of skill, care, and diligence, is more related to oppression remedy than the fiduciary duty under 122. (1) (a) of the *CBCA*. Due to this project evolving around fiduciary duty to act honestly and in good faith with a view to the best interests of the corporation, oppression remedy would benefit from its own dedicated research that would tie it with the conduct of corporate management. Doing so in this project would have been complementary to exploring the notion of corporate governance shifting from shareholder primacy model to team production theory, but would require its own extensive literature research and analysis, which fall beyond the scope of the limited space in this project. Another vital aspect of corporate accountability that has not been discussed is securities law. Under the *Securities Act, RSO 1990, c. S-5, s. 1.1.*, the purpose of the act is, 1.1 (a) to provide protection to investors from unfair, improper or fraudulent practices. This has been used to demonstrate the explicit mention of investors, by an extension, shareholders as the primary stakeholder. MacIntosh stated, "While the Supreme Court has rejected shareholder primacy, the legislative mandate of securities regulators extends only to the protection of 'investors'. This embraces more than shareholders, but considerably less than the full array of corporate constituencies empowered by *BCE* to complain about directorial and/or corporate conduct. In fact, the securities regulators have mostly paid attention to shareholder interests in their travails." Please see MacIntosh, "Directors' Duties in Canada", *supra* note 5 at 65.

[192] VanDuzer, BCE v. 1976 Debentureholders, *supra* note 12 at 251.

[193] *Ibid* at 249.

[194] ---*supra* note 132.

governance. This team production model shifts away from the shareholder primacy model to focus on the long-term interest of the corporation and the consideration of multiple stakeholders' interests instead of only one stakeholder, the shareholder. As previously argued, this is the appropriate model for Canadian corporate governance. Moreover, the shift toward a broader interpretation of fiduciary duty has involved different normative and positive perspectives. From a positivist perspective directors are independent hierarchs whose fiduciary obligation is to the corporation entity itself and only instrumentally to any of its participants. From a normative basis the law ought to work this way by preserving directors' independence and imposing on them fiduciary obligations that run to the firm as a whole and not to any particular team member.[195]

Team Production Theory: The Alternative to Shareholder Primacy

Team production theory has been proposed as the alternative to the principal-agent model shareholder, where the principal of the corporation is not the shareholder; rather, the corporation itself takes on the role of the "mediating hierarchy."[196] The alternative mode to shareholder primacy is to be the centre of internal governance structure.

[195] Blair & Stout, A Team Production Theory of Corporate Law, *supra* note 5 at 249.
[196] *Ibid.*

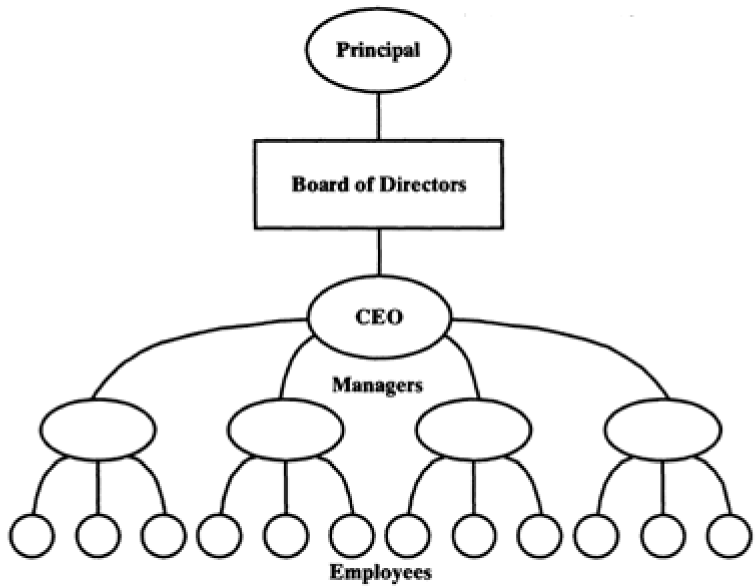

Figure 1: Corporate Governance Structure[197]

As shown in Figure 1, the principal is the corporation, the mediating internal hierarchy (the board of directors) who represent the corporation and mediate between the horizontal interaction of the different stakeholders within the corporation, but represent the interest of the corporation and not necessarily one specific stakeholder.[198] The next sections will explain team production theory and assess the theory as an alternative to the principal-agent model that has dominated Canadian corporate governance in the 19th and early 20th century.

What is Team Production Theory?

Team production theory values the various groups who provide input into the firm.[199] Rather than valuing the contributions of the shareholder (in terms of financial investment in the company) over other input, after meeting contractual obligations, the output is spread out evenly

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[197] *Ibid* at 262.
[198] *Ibid* at 250.
From a Canadian perspective, please see the work of Ben-Ishai, *supra* note 5; While Ben-Ishai focuses more on the oppression remedy, I rely on Blair & Stout for the majority of the team production theory.
[199] Blair & Stout, A Team Production Theory of Corporate Law, *supra* note 5 at 255.

among the shareholders rather than various groups. Team production theory aims to change that by valuing the input of all groups. The various groups are stakeholders of the corporation, the shareholders, bondholders, employees, potential creditors, and the community at large if applicable to geographical ties and socio-economic impact of the corporations operating in smaller towns. Due to each group providing different input to the team, team production theory emphasises the value of each input and rewards the different groups by ensuring each group earns a fair share of the benefits according to the production they contributed to the corporation.[200]

The focus of team production theory is to ensure various groups within the corporation benefit from their different contributions to the firm.[201] An assumption in a successful enterprise would have different groups contributing to the firm with the goal of producing a profitable output. The profit would be shared by the different groups that contributed.[202] The groups all contributed by different means, and, as a result, they would all benefit. Take, for example, designing a new smart self-driven car. The engineers working on the car would classify as one group; they would contribute their service expertise by working on the design of the car. Another group would be the employees in the manufacturing plant who contributed their physical labour to assemble the car. The investors are a group who provide monetary contributions to enable further research on how to design the car. Other groups would be the executives who are in charge of managing operations and leaders of the firm who provide stewardship and management to ensure continued operations.[203] Each group contributes differently, and the self-

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[200] *Ibid.*
[201] *Ibid* at 263.
[202] *Ibid*.
[203] This is not an exhaustive list, rather it is designed to highlight the different contributions that would be made to the firm.

driven car has been designed and becomes operable and sold in the market. All groups would benefit from the profit of the vehicle after the expenses have been covered.

Applying the hypothetical scenario of a smart, self-driven car to the shareholder primacy model, would demonstrate stark differences from the team production model. The shareholder primacy model would focus on fixed claimants v. residual claimant, i.e. the shareholder. After contractual obligations had been met with fixed claimants including, for example, salary payments to employees, fees to the creditors as per the contract of the fixed claimants, the remaining profit would go to the shareholders who are the residual claimants according to shareholder primacy.

Profit distribution is not the only means that differs between shareholder primacy and team production theory. A major element of team production theory is horizontal interaction among the various groups. As seen in Figure 1, horizontal interaction within the corporation is encouraged. Emphasis would be on the horizontal cohesion among groups, because the distribution of profit is even. Different groups within the corporation are encouraged to support each other, as that will assist in benefiting all the various groups, and will, thus, benefit the corporation.[204]

Two potential problems of the increased horizontal interaction and equal distribution of profit to the different groups are shirking and rent-seeking. Shirking usually occurs when a profit is evenly distributed, and groups rely on certain strong performers to carry the successful operation of the corporation, thus, free-riding on others' effort.[205] Rent-seeking has the potential to pose more problems than shirking. Rent-seeking occurs in negotiations for fixed profit and the

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[204] Blair & Stout, A Team Production Theory of Corporate Law, *supra* note 5 at 264.
[205] *Ibid* at 266.

size of the profit that each group deserves. Due to the reality and nature of bargaining for the appropriate fair share of the profit, rent-seeking can potentially attribute to time and money spent by each group advocating for the proper share of the profit for their group. This can cause internal strife especially in horizontal interaction, where groups might not feel others are superior to them.[206]

Countering these problems is done by proposing a mediating hierarchy as the solution for horizontal interaction. This hierarchy will decide on profit distribution as well as other major decisions. "The mediating hierarchy solution requires team members to give up important rights (including property rights over the team's joint output and over team inputs such as financial capital and firm-specific human capital) to a legal entity created by the act of the incorporation."[207] As a result, the assets of the corporation then belong to the corporation itself rather than the shareholders. Rent-seeking would be solved or contained by allowing the mediating hierarchy to decide the appropriate distribution of profit, because each group gives up a certain right. As mentioned by Stout and Blair, this includes the management of financial capital in return for benefits that are appropriately managed. Internal strife would be reduced or potentially eliminated. Each group can raise claim to the mediating hierarchy. The mediating hierarchy can also identify if each group is shirking and determine the appropriate consequences. This might resemble the social contract of a democratic society, where individuals in society give up certain rights for freedom and benefits.[208]

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206 *Ibid.*
207 *Ibid* at 250.
208 *Ibid.*

The Mediating Hierarchy

In replacing the shareholders and making the corporation itself the principal, the governing body is not then an abstract fictional idea; rather it is positioned as an internal governance structure that is the mediating hierarchy. The mediating hierarchy is designed to respond to inherent or arising problems from horizontal coordination among the different groups within the corporation. However the internal governance structure is more than a liaison between the various groups. Its primary function is to exercise that control in a fashion that maximizes the joint welfare of the team as a whole.[209]

This internal governance structure, the mediating hierarchy, is the board of directors who have been granted extensive authority, including control of the corporate assets. This internal hierarchy as represented by the board of directors' main functions include coordinating activities among team members, allocating the production, and mediating disputes among team members over that allocation.[210] "At the peak of this hierarchy sits a board of directors whose authority over the use of corporate assets is virtually absolute and whose independence from individual team members is protected by the law."[211]

The board of directors is made up of representatives from each team but also includes outside and internal directors whose main representation is the corporation itself. All directors operate with the same vested authority, and are equal in their legal standing.[212]

> The board enjoys ultimate decision-making authority to select future corporate officers and directors, to determine the corporate assets, and to serve as an internal 'court of appeals' to resolve disputes that may

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[209] *Ibid* at 271.
[210] *Ibid* at 251.
[211] *Ibid* at 250.
[212] *Ibid*.

> arise among the team members The act of forming a corporation thus means that no one team member is a 'principal' who enjoys a right control over the team.[213]

In resolving disputes between team members, the board of directors has the task of addressing rent-seeking and shirking. This is a fundamental shift from shareholder primacy, where the board of director's primary fiduciary duty, as owed to the corporation, is to pursue shareholders' interests, because it was falsely understood that the shareholders were the owners of the corporation. However, the progression toward a broader understanding of the fiduciary duty of directors is now correctly understood as maximizing the value of the corporation and looking after the best interest of the corporation, which includes taking into consideration multiple stakeholders. The fiduciary duty of directors is to also balance team members' competing interests.[214]

Another fundamental difference between shareholder primacy and team production is the principal-agent model. In shareholder primacy, the principal is the shareholder and the agent is the director.[215] While a disagreement may arise from the fact that the directors are not subservient to a particular stakeholder and controlled by one stakeholder, the important element of team production theory is that the board of directors is the independent decision-making body with the vested authority to guide the corporation.

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[213] *Ibid* at 271.

[214] As will be seen in later sections, I argue that the principal in corporate governance is the "long-term interest of the corporation" and that is per Canadian common law cases. As stated in the Supreme Court case of *BCE* the fiduciary duties of the board of director is owed to the long-term interest of the corporation. *BCE, supra* note 6 at para 37.

[215] Blair & Stout, "A Team Production Theory of Corporate Law", *supra* note 5 at 290. Stout and Blair cite the work of Dean Robert Clark to refute this perspective: (1) corporate officers like the president and treasurer are agents of the corporation itself; (2) the board of directors is the ultimate decision-making body of the corporation (and in a sense is the group most appropriately identified with "the corporation"); (3) directors are not agents of the corporation but are sui generis; (4) neither officers nor directors are agents of the stockholders; but (5) both officers and directors are "fiduciaries" with respect to the corporation and its stockholders." For further reading, please see Robert C. Clark, "Agency Costs versus Fiduciary Duties" in John W. Pratt & Richard J. Zeckhauser eds., *Principals and Agents: The Structure of Business* (Boston: Harvard Business School Press, 1985).

Moreover, team production theory addresses the interest of the corporation to be inclusive and value the investment made by employees as well as the financial investment contributed by the shareholder.[216] The investment of an employee can take several forms. Take for example, scientists who have been working on new drugs for over four years, and that drug has patent claims by the corporation which the scientist worked to develop. As a result, that scientist developed firm-specific knowledge that will not be transferable outside the firm. This type of investment becomes valuable to the firm, but more importantly, it potentially leaves the employee vulnerable to the firm with an investment that cannot be measured by monetary value. On the other hand, investors with financial investment in the corporation have the luxury of transferring or exiting the firm for another one. As a result, this type of investment made by an employee and knowledge-specific, must be taken into consideration, and that is why team production puts a strategic emphasis on the input of all members. That output, resulting in profits to the enterprise must not normatively favour the shareholders to the exclusion of other team members.

The Proposed Canadian Corporate Governance Model

Two models of corporate governance have been examined, shareholder primacy, and team production theory. The following section will present more emphasis on the Canadian landscape in corporate law. An analysis of the appropriate model for Canada will be proposed—one that combines the two corporate models. There are features of both models that can create a new alternative in corporate governance.[217]

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[216] Blair & Stout, "A Team Production Theory of Corporate Law" *supra* note 5 at 274.
[217] Since proposing a model for corporate governance can in itself form a whole thesis, it will suffice to demonstrate the major features of the type of corporate governance model that I am endorsing that will instrumentally assist in determining the best approach of fiduciary duties of directors.

The regulation of corporations in Canada can be documented in statutes. Federally it is the *CBCA*, and the cases derived from common law; provincially in Ontario it is the *OCBA*. Historically the federal government did not externally intervene in Canadian corporate governance; rather the courts were more vocal than the legislature branch. In Canada, until early in the 20th century, the courts took a position that directors' fiduciary obligation as owed to the corporation was to maximize the wealth of shareholders, a reflection of the shareholder primacy model that dominated corporate governance landscape in Canada for many years. The fiduciary duty of directors to the corporation was interpreted as being equated with the interests of the shareholders. However, this has changed, and this change has been marked by common law, rather than statutes. The Supreme Court of Canada shifted from the narrow interpretation of fiduciary duty, to the current views of the duties of directors and officers as owed to the long-term interest of the corporation to include consideration of the interests of multiple stakeholders.[218] This provides a similar model advocated by team production theory. As previously discussed, this was laid out in the Supreme Court case of *BCE* and marked a shift away from the shareholder primacy model of corporate governance. However, the shift was advocated long before the Supreme Court's decision was put forth. Academic literature has been extensive in calls to broaden the scope of fiduciary duty as including the interests of various stakeholders within the corporation.[219] The next section will analyze the corporate governance model, one that differs from shareholder primacy and resembles team production theory.

The Corporation as a Legal Person

The regulation of the corporation as a legal person by law requires the corporation to act within the boundaries of the law. This also takes into account ethical considerations that must be

[218] *BCE*, *supra* note 6 at para 37.
[219] The leading literature is Blair & Stout, "A Team Production Theory of Corporate Law" *supra* note 5.

respected by the corporation as a legal entity. While this does not correlate with shareholder primacy, it is important to note that the pursuit of maximizing the wealth of shareholders is already limited by the boundaries of the law as set out due to the fact that the corporation is a legal person with rights and duties.[220] Moreover, the liability of the corporation flows according to societal expectations. Emerging news of oil spills, plant disasters, and work safety are all part of an increasingly higher expected standard of what is required from a corporation in ensuring appropriate levels of due diligence. High levels of public awareness of corporate negligence increase calls from the public for stricter regulations.

The Alternative Model: Mixture of Shareholder Primacy and Team Production Theory

It is vital to note that the long-term interest of the corporation *may* be to increase the returns of shareholders investments.[221] For example, the maturity of a corporation and the long-term interest of the corporation might require the board of directors to place the interest of one group over the others to ensure overall success for the firm. Fiduciary duty as owed to the corporation does not translate into every team member receiving a share in the remaining profit of a corporation.

After the minimal contractual obligation has been met, team members might not receive bonuses. The remainder can go toward maximizing the interest of the shareholders, and this can be justified by the board of directors to attract as much investment as possible for the corporation. However, the difference between this form of governance and shareholder primacy

[220] The concept of a corporation as a legal person originated in the United Kingdom. The case of *Salomon* v *Salomon* & Co Ltd [1896] UKHL 1, emphasises the corporation as a legal person.

[221] While, I fundamentally agree with Stout and Blair, I am of the opinion that maximizing the wealth of the shareholder can be done, but must not come at the detriment of other stakeholders. I differ from enlightened shareholder value (ESV) because ESV puts shareholders at the primacy. I object to this notion of primacy. The best interest of the corporation, as will be discussed in the next chapter, is the primary driver for any long-term decision making. The board of directors has authority only if it is used appropriately in the interest of the corporation.

is that maximizing the wealth of the shareholders must not be the normative behaviour of the board of directors, especially if it is detrimental to other stakeholders. Another example is that profits can be put toward investing into the corporation, rather than given to the shareholders.

In a hypothetical scenario, the board of directors might decide that it is in the long-term best interest of the corporation to invest heavily in research and development. For example, consider corporation A, which has been successful and investors are investing and profit has been expanding each year, and each team member receives a generous bonus. The board of directors might fundamentally agree that in year X the corporation has reached its peak, and, thus, needs to invest more in research and development or risk having a decline in profits. As a result, not every team member will receive a bonus because of heavy investments in research and development. Moreover, it might also occur that one group, the shareholders, are the beneficiary of a bonus in the form of a dividend for that year, as a gesture or as a move to encourage more investments for the corporation, both moves are in the long-term best interest of the corporation at the expense of employees who will only see their contractual benefits being met. Such decisions are a product that is a mixture of the shareholder primacy feature, but fundamentally it is not for the best interest of the shareholder. Rather it is end goal of the long-term interest of the corporation with the means being the benefit to shareholders and research and development.

The *Corporate Governance Handbook: Legal Standards and Board Practices* by the Conference Board of Canada has set out to discuss the roles of board and management in terms of shareholder and stakeholders relations. The Conference Board has set out for the following in terms of stakeholders' interest:

> The board is accountable for the performance of the corporation and the pursuit of wealth on behalf of shareholders. However, while designing a long term strategic plan, directors, should be mindful that shareholder value depends on a nexus of relations with other business stakeholders, including employees,

> suppliers, and customers, and the local communities where the company operates. In the performance of its responsibilities, board members, should remain sensitive to the company's key interest constituencies and ensure that senior executives act in a manner that preserves and enhances such crucial relations.[222]

While this does not resemble team production theory, it also does not represent shareholder primacy. With an additional caveat, it can be argued that this represents a more centric balance between shareholder primacy and team production theory. This caveat replaces "shareholders" with "the corporation" in the first statement. Therefore, it can be stated as the board is accountable for the performance of the corporation and the pursuit of wealth on behalf of the corporation. This substitute is important because the pursuit of wealth on behalf of shareholders may not benefit anyone other than the shareholders. The pursuit of wealth on behalf of the corporation itself can benefit everyone and it certainly can benefit shareholders as well. This is not an issue of a nuance of the statement or wording of the statement "maximizing wealth of the corporation instead of shareholders;" rather it is crucial for the board to be accountable in pursuing the maximization of the profit and wealth of the corporation, as it will benefit more than one group, and it certainly can benefit the shareholders accordingly. It is crucial to note that fiduciary duty has always been consistently applied by the courts to be owed to the corporation. Historically, this interpretation has meant owed to shareholders, because it was thought that the interests of the corporation were the interests of the shareholders. As a result, the interests of the company were defined exclusively in terms of shareholder wealth maximization. The evolution of fiduciary duty does not mean it is shifting from shareholders to the corporation; on the contrary, fiduciary duty is still owed to the corporation. The evolution of the interpretation of fiduciary duty owed to the corporation means that the board of directors has to maximize the wealth of the corporation as a whole, not only to shareholders. In so doing, the board of directors may consider multiple stakeholders' interests.

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[222] *Corporate Governance Handbook: Legal Standards and Board Practices (*Ottawa, ON: The Conference Board, Inc., 2009) at 23.

In maximizing the value of the corporation, the board of directors may focus on one or more stakeholders only if their interest aligns with the long-term interest of the corporation. For example, if the board of directors believe focusing on the shareholders will be in the long-term interest of the corporation, they can focus on attracting more investors, or the board of directors might focus on investing in research and development and not specifically any stakeholder as that might potentially be in the best interest of the corporation. The board of directors has the ability to determine what is in the best interest of the corporation, and in decision making, one or more stakeholders may be the recipient of the board of directors' decision. To benefit the shareholders accordingly, the board of directors must take into consideration the environment setting and maturity state of the corporation. For example, for a corporation at the initial public offering (IPO) stage of their corporate life, the board of directors can pursue to maximize the wealth of shareholders, as doing so will be seen as a strategic move to further increase investment in the corporation. In future years of the corporate life, if a corporation has hit its peak and investors are hesitant of the company's direction, the board of directors can then shift the focus to research and development. The reason for providing the board of directors with the flexibility to determine what is best for the corporation, heavily investing in research and development or maximizing the profit of a particular stakeholder, will allow for decision making to be in the best interest of the corporation. This flexibility for the board of directors means they are responsible for the best interests of the corporation. This more centric model of corporate governance, while not exactly team production theory or shareholder primacy, is one that focuses on the overall long-term interest of the corporation.

In cases where the board of directors and the management are in conflict, the interest of the stakeholders must be objectively considered. For example, if due to financial difficulties and budget constraints, Corporation A decides to cease its operations in a plant in Windsor, Ontario, in favour of relocating overseas to a plant with lower projected operational costs, this might benefit the shareholder. However, it will come at the expense of the current employees in that they will lose their jobs. If the management in corporation B, faced with the same scenario, decline to shift production in favour of retaining employees and maintaining their location in the community that has provided them with benefits, such as tax breaks, building more accessible roads, better transit and infrastructure, this would come at the expense of the shareholders, as the return on the invested capital might be projected to be much smaller than what was initially anticipated. Under the shareholder primacy model, Corporation A would have acted appropriately, but the directors of Corporation B would not have complied with their fiduciary duties to the corporation. Under team production theory, Corporation B would have acted appropriately, but directors of Corporation A could be held liable for breaching their fiduciary duty to all team members. A centric model of corporate governance will assess and analyze if both corporations have taken the appropriate measures to reach the best decision by focusing on what is in the best interest of the corporation. Engaging in this hypothetical scenario, the board of directors might decide to hire an independent consulting firm to assist the board in coming up with a sound decision. In the long term the corporation will not benefit if operations move overseas, as expenditure will not decrease sufficiently to offset the cost of relocation, and profits stagnate at the same levels. The board of directors will vote for not relocating overseas, as it is in the long-term best interest of the corporation. In coming to this decision, the interest of every stakeholder has been closely assessed, while in the short term, relocating will provide shareholders with a greater profit for their investments. In the long term the profits would not increase for the shareholders if they stayed in their existing location, but the shareholders would still claim a good margin of profit. More importantly, the benefits would be greater for other stakeholders, for the employees would maintain their jobs, and the community would benefit from the corporation operating in their town.[223] The decision of the board of directors is, thus, a feature of shareholder primacy and team production theory that weighed the interest of all stakeholders.

As will be seen in the next section, the business judgment rule (BJR) is a crucial instrument in determining how the board of directors can reach a decision that will be upheld by the judiciary if challenged. More specifically, decision making in a corporation that is near insolvency is more challenging, as it is bound to face conflicting competing interests from multiple stakeholders. Inevitably, creditors, employees and the shareholders will have competing stakes.

[223] I do not intend to oversimplify such complex decision making by any corporation in coming up with a decision in the hypothetical scenario. However, engaging in such hypothetical scenario allows for the corporate governance model that I am promoting to be displayed and how well it can benefit under tough decision making when interests of stakeholders are conflicting.

Chapter 3:
The Business Judgment Rule: Examining the Boundaries of Directors' Conduct

When discussing the fiduciary duty and the conduct of the board of directors, the business judgment rule (BJR) is relevant, as it is the defence mechanism that boards of directors use against claims that they breached their fiduciary duty as owed to the corporation. For example, if shareholders of a corporation bring a claim of breach of fiduciary duty against the board of directors, that is the board of directors have not been acting in good faith with a view to the best interests of the corporation, they can claim that their decision making has been made in good faith with a view toward the best interests of the corporation, and deference must be granted by the courts to their decision making via the business judgment rule. Therefore, the courts do not have to second guess the directors' decisions.

In regard to the BJR, the SCC in *BCE* has stated the following:

> In considering what is in the best interests of the corporation, directors may look to the interests of, inter alia, shareholders, employees, creditors, consumers, governments and the environment to inform their decisions. Courts should give appropriate deference to the business judgment of directors who take into account these ancillary interests, as reflected by the business judgment rule. The 'business judgment rule'accords deference to a business decision, so long as it lies within a range of reasonable alternatives…It reflects the reality that directors, who are mandated under s. 102(1) of the CBCA to manage the corporation's business and affairs, are often better suited to determine what is in the best interests of the corporation. This applies to decisions on stakeholders' interests, as much as other directorial decisions.

Scholars who favour shareholder primacy theory, a narrow interpretation of the fiduciary duty, have a different perspective of the business judgment rule (BJR) than scholars who favour team production theory, which offers a broader interpretation. To pro-shareholder primacy scholars, the SCC in *BCE*, by granting high deference of the BJR to not second guess the business decision made by the board of directors, actually reduces directors' accountability and liability. To those scholars, *BCE* has directed the following:

> *BCE* is understood to open the door to non-shareholder stakeholders to argue that the directors have not acted in the best interests of the corporation by treating them unfairly or have defeated their reasonable expectations by doing so because the business judgment rule provides sufficient deference to director and officer decision making that the risk of liability is remote. Taken together, an uncertain standard that varies with the circumstances and is subject to the deference of the business judgment rule reduces director and officer accountability in general.[224]

According to shareholder primacy theorists, because the courts endorsed the deference of the BJR, meaning courts will not second guess management decision-making, directors can continue to operate with the view of maximizing the wealth of shareholders, and in doing so will be protected by the BJR's high level of judicial deference, which reduces their accountability. Thus it will be difficult for non-shareholder stakeholders to claim breach of fiduciary duty as directors can claim protection under the BJR.[225] The purpose of this chapter is to refute those claims and demonstrate that the courts will not automatically grant deference to the BJR; rather, the courts are willing to examine the conduct of the directors, thus making it improbable that post-*BCE*, boards of directors can operate, by only considering the interest of the shareholders without taking into consideration the interests of nonshareholder stakeholders. Prior to refuting the claims made by pro-shareholder scholars, it will be necessary to first examine the business judgment rule as a legal concept.

A doctrine that highlights the intersection between business decision-making and the judicial system, and one that is embedded in the core discussion of corporate governance is the BJR. As decided in the case of *BCE*, deference should be accorded to the business decisions of directors taken in good faith and in the performance of the functions the directors were elected by the shareholders to perform.[226] The BJR, however, has been referred to as the mechanism that

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[224] *Ibid* at 252.
[225] Please see the work of Bainbridge, Director Primacy, *supra* note 5; MacIntosh, "*BCE* and *Peoples*' Corporate Law", *supra* note 53; *supra* note 12. All three scholars have criticized the vagueness surrounding the discussion of the BJR.
[226] *BCE, supra* note 6, para 99.

will protect directors for continuing with the shareholder primacy model, and maximizing the wealth of shareholders, instead of taking into consideration the interest of other stakeholders.[227] The purpose of this chapter is to refute such claims, by analyzing the boundaries of the BJR which will demonstrate that the deference granted by the courts to the management of the corporation is within reasonable limits, and does not shield management in order to maximize shareholder wealth at the expense of other stakeholders,.

Historically, directors and officers have always maintained a space between personal liability and corporate liability. The influence of the corporation as a legal person extends to the BJR as to respect the boundaries and space of directors and officers.[228] The BJR can be used today to insulate boards of directors from claims that their decision making, which may have negatively impacted the corporation, was not made improperly or without due consideration.[229] As a result, the courts rely on the BJR in order to not second-guess decisions made by the board of directors.[230] However, different commentators do not agree on either its theoretical underpinnings or the policy justification.[231] Due to the strength of these divisions, it is best to organize the discussion into separate schools of thought along theoretical and policy lines.[232] One prominent school of thought argues that the BJR is an abstention doctrine,[233] while another school of thought classifies it as a standard of liability by which courts review the decisions of boards of directors.

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227 ----*supra* note 12.
228 Please see *Salomon v A Salomon & Co Ltd*, 1896 UKHL 1, [1897] AC 22. The discussion of corporate identity and the corporation as a legal person is separate from the discussion of the BJR. However, what is similar is the discussion around respecting the boundaries of the directors and officers in making decisions for the long term interest of the corporation.
229 *BCE, supra* note 6 at para 40.
230 *Ibid.*
231 Bainbridge, Director primacy, *supra* note 45 at 601.
232 *Ibid.*
233 Please see Stephen M Bainbridge, "The business judgment rule as abstention doctrine" (2003) UCLA, School of Law, Law and Econ. Research Paper 03-18.

Although the BJR has garnered much attention in academic circles, it has yet to receive the same volume of discussion by the Canadian judiciary as a provision of certainty to directors to operate with confidence and full knowledge of the law.[234] Canadian corporate law has experienced a far smaller volume of cases at the nation's top courts in comparison to the United States. Similarly to the previous two chapters, this chapter will rely on Canadian scholarly academic work, as well as Canadian cases that articulated the requirements of the BJR. Perhaps more importantly, it will define the criteria used to grant deference to the BJR that allows corporations to understand their duties and responsibilities. At the same time, the BJR has been defined and has posited different interpretations of the rule and its elements. Nevertheless, a common characteristic in these various interpretations is that the BJR stipulates deference to directors and officers who have made executive business decisions to avoid liability, in order to allow themselves to make tough decisions with enough flexibility to accommodate errors. As Samuel Arsht explains,

> The term 'business judgment rule' and the presumption that often identifies it mean simply that a stockholder who challenges a nonself-dealing transaction must persuade the court that the corporation's directors, officers, or controlling stockholders in authorizing the transaction did not act in good faith, did not act in a manner they reasonably believed to be in the corporation's best interest, or did not exercise the care an ordinarily prudent person in a like position would use under similar circumstances.[235]

The challenge is, thus, that the BJR cannot be discussed in isolation; it requires explanation alongside the fiduciary duty owed by directors and officers. As Arsht also explains, whoever challenges a corporation's decision making bears the onus of proving that the directors and officers did not act in good faith and in the best interest of the corporation, while corporate management would defend that their conduct ought to be protected by the BJR.[236] The tension between BJR and the fiduciary duties of directors is, thus, necessarily concerned with a nuanced

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[234] The business judgment rule in Canadian cases is limited in volume in comparison to United States.
[235] Greenfield & Nilsson, "Gradgrind's education, *supra* note 104 at 818.
[236] *BCE*, *supra* note 6 at para 40.

fiduciary duty. Whether the duty is to only consider shareholders' interests, or to consider the interest of each constituent of a corporation, a combination of these parties will likely affect the BJR's application.[237] Scholars who have analyzed the tension that emerges between the two concepts of BJR and the fiduciary duty have examined this with the interpretation of the fiduciary duty as one that maximizes the wealth of the shareholder.[238] However, in this chapter, BJR will be examined alongside fiduciary duty with the interpretation of fiduciary duty encompassing multiple stakeholders' interests, through the model of team production.[239] In *BCE*, the SCC shifted away from directors' duty to consider only maximizing shareholders' wealth, which in turn affected the BJR by requiring the courts to define the requirement that would give rise to directors' and officers' deference to the rule.[240] The impact of recent developments in Canadian corporate law were to view fiduciary duty as owed to the long-term interest of the corporation, which does not necessarily mean moving away from maximizing shareholders' wealth, as long as it is compatible with the organization's long-term interests. However, it does mean that the corporation's long-term interests can include other goals than maximizing the shareholders' wealth, for example, the interests of the community, employees, creditors, and suppliers.[241] Of equal importance, the courts' deference to the BJR does not mean that it emancipates directors and officers from their fiduciary duty. Instead, it questions whether these duties have been fulfilled, largely as an effect of shifting the fiduciary duty away from

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[237] For example, the application of Business Judgment Rule if the fiduciary duty is owed only to the shareholders is different than the application of BJR if the fiduciary duty is owed to multiple stakeholders. That is because the conduct of the directors differ under different corporate governance model.
[238] Bainbridge, Director Primacy, *supra* note 45.
[239] In chapter two I have endorsed a model that is a mixture of shareholder primacy and team production theory. However, in the discussion of the BJR, sticking with the team production theory is useful to demonstrate that the BJR cannot be used a shield that will protect directors from focusing only on shareholders.
[240] *BCE*, *supra* note 6 at para 40.
[241] *Ibid* para 39; *People*s, *supra* at para 42.

maximizing only the wealth of shareholders to a broader reading that takes multiple stakeholders into account.

This chapter will examine the BJR in relation to the expanded interpretation of the fiduciary duty to incorporate the interest of multiple stakeholders, and not exclusively shareholders. This transformation requires practical guidance for corporate management. Examining the conduct of the directors through the business judgment rule will assist in providing practical guidance.

In light of this perception, the BJR has two components. First, it constitutes the presumption that the directors' actions were taken in good faith and in alignment with their fiduciary duty.[242] The second component is one of substance, in which the directors will not be held liable due to action arising from their decision making, *only* if the decision making, in question, is reasonable.[243]

Historical examination of the courts' reliance on the BJR highlights a cautious approach, one that balances the need to allow officers and directors the deference needed to formulate a business decision while cautiously leaving room for the courts to decide if the conduct of those officers and directors is reasonable. This approach has been characterized as vague and rather sets a lower threshold for the standards of accountability of the directors and officers.[244]

I contend that the BJR is neither a full abstention doctrine nor a standard of liability. This is not to say that these are false binaries; on the contrary, they represent the appropriate binaries. The BJR represents a middle ground that has been utilized by the courts with the intention of

[242] Greenfield & Nilsson, "Gradgrind's education", *supra* note 104 at 842.
[243] *Ibid*.
[244] Please see the work of Bainbridge, Director Primacy, *supra* note 5; MacIntosh, "*BCE* and *Peoples*' Corporate Law", *supra* note 53; *supra* note 12. All three scholars have criticized the vagueness surrounding the discussion of the BJR.

ensuring an appropriate, objective balance[245], a balance that respects the freedom of officers and directors of corporations to make business decisions while abiding by duties and obligations as set forth in common law and legislation. This leaves it open to the court to intervene if need be. In order to establish the abovementioned purpose, it is necessary to set the framework of what the courts have found to be unreasonable conduct in case law that has rejected the deference of the BJR. This is vital because it has been argued by the shareholder primacy theorists that directors may continue to only consider the interests of the shareholders. If a claim of a breach of fiduciary duty arises, directors can argue that their decision-making process is protected under the BJR.[246] Being neither an abstention doctrine nor a standard of liability is necessary, as it demonstrates that the courts will not automatically grant deference or get involved in corporate conduct; rather, the courts will examine if the directors followed clear boundaries, and the directors and officers must make decisions that do not step outside of said boundaries. In order to establish those boundaries, it is important to discuss the *unreasonable* first, the space that is outside of the boundaries. In other words, what has previously been considered unreasonable that allowed judges to not grant deference to the BJR, thus, rejecting and overriding decisions made by directors and officers.

When directors and officers operate within a specific boundary it will assist in establishing the parameters of common law; it will also denounce the claim that the BJR is a doctrine of abstinence. To counter the argument that the court utilization of the BJR has been vague and set the standards of accountability to a lesser degree for the corporation

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[245] In discussing objectivity, the action of the directors and officers will be based on an objective metric. This is a shift away from the subjective standard that directors were once held.
[246] ---*supra* note 12.

management,[247] it is vital to demonstrate the approach of the court, where an appropriate balance will help to increase the certainty and predictability of the framework for officers and directors. More importantly, it will demonstrate why the shareholder primacy model of corporate governance cannot be protected by the BJR.

Theoretical Framework

Bainbridge asserts that the BJR is the chief common law corollary to the separation of ownership and control.[248] The courts recognize that there will always be a tension between authority that is vested in the board of directors and officers and their conduct via their fiduciary obligations toward various constituents.[249] In the primary context of large corporations, the separation of ownership and control is highly visible.[250] The potential implication of this is that the controllers, the board of directors and officers, might be too powerful.[251] Directors are vested with the power to manage the firm.[252] This can also lead to abuse because of the delegation of management and power, i.e., the abuse of discretion and managerial misconduct. Hence, Bainbridge asserts that the BJR is the chief common law corollary to the separation of power and control. Being able to make accurate predictions about the BJR's scope and content, thus, stands as the basic test for any model.[253] I differ in part from Bainbridge when he proposes that the courts will abstain from reviewing the exercise of directorial discretion. Bainbridge states:

> I contend that the business judgment rule is the doctrinal mechanism by which courts on a case-by-case basis resolve the competing claims of authority and accountability… The business judgment rule prevents

[247] Puri, Future of Stakeholder Interests in Corporate Governance, *supra* note 12; and VanDuzer, BCE v. 1976 Debentureholders, *supra* note 12.
[248] Bainbridge, *supra* note 45 at 601.
[249] The word "constituents" has been used interchangeably with stakeholders.
[250] This is not to say that shareholders are true owners of the corporation. For further discussion of the delegation of power in large corporations, please see Blair & Stout, "A Team Production Theory of Corporate Law" *supra* note 5 at 247.
[251] Stephen M. Bainbridge, Director primacy, *supra* note 45 at 601.
[252] ---*supra* note 49.
[253] Bainbridge, *supra* note 45 at 601.

> such a shift in the locus of decisionmaking authority from boards to judges by establishing a limited system for case-by-case judicial oversight in which review of the substantive merits of those decisions is avoided. Specifically, the court begins with a presumption against reviewing the merits of board decisions. The court then examines the facts of the case to determine not the quality of the decision, but rather whether the board's decisionmaking process was tainted by self-dealing. Whether or not the board exercised reasonable care is irrelevant, as well it should be. The business judgment rule thus builds a prophylactic barrier by which courts precommit to resisting the temptation to review the merits of the board's decision.[254]

It is accurate that the BJR prevents a shift in the locus of decision-making authority from boards to judges, and courts do not want to make business decisions in the courtroom and they rightly must not do so. However, the courts have established reasonable boundaries within which directors can operate; directors may not step outside of these boundaries.[255] Whether or not the directors consider the interest of multiple stakeholders is a vital question. Because in cases of tension between competing stakeholders' interests, the emphasis of the traditional shareholders primacy model is that the maximization of shareholder wealth trumps any other stakeholder interest. This is distinct from current Canadian case law, and what has been advanced in this thesis. This is not to say that the directors should not maximize the wealth of shareholders—that could be a valid goal of any corporation's board of directors—however, this must not be done while neglecting other stakeholders' interests. Chapter two discusses in great length through the Supreme Court decision in *BCE* that fiduciary duty is owed to the long-term interest of the corporation and not concerned with short-term profits for shareholders.

To return to the focus on the BJR as a doctrine that deals with the accountability of corporate management, the courts have established the necessary framework wherein the decisions of boards of directors and officers are reviewed for the manner in which those decisions were made and whether all correct interests were considered. These are the previously referenced boundaries that the court has established in case law.

[254] *Ibid.*
[255] This will be demonstrated in the next section where I analyze case law related to the BJR.

Many scholars have referred to the Supreme Court's decision in *BCE* as a high level of deference endorsement of the BJR.[256] This is highlighted in the following:

> The resulting lack of predictability in the Supreme Court's fiduciary standard increases the challenge for boards of directors and their advisors struggling to determine what is required. At the same time, however, boards would seem to have greater flexibility under the Supreme Court's version of the fiduciary duty, as compared to a duty that requires directors to maximize shareholder value, especially given the Court's strong endorsement of the deference to their decisions that is required under its expansive conception of the business judgment rule [BJR]. The net effect is that, while directors and officers may have difficulty understanding their obligations, they will be less accountable after *BCE* for what they decide to do.[257]

The important question remains: Did the Supreme Court reduce the liability of directors by endorsing the BJR coupled with what is being called vague conception of fiduciary duty owed by directors to the long-term interest of the corporation?[258] It is important to note that the court's high level of deference to directors and officers under the BJR can easily be misread to state that the courts will not examine the merits of directors' business decisions. On the contrary, the courts acknowledge the tension between the BJR and the fiduciary duty of directors and are prepared to let that tension play out in court while they willingly examine it. The high level of deference referred to is not without its limitations. Director's business decision must lie within a range of reasonable alternatives.[259] To reiterate, BJR is a concept with its limits.

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[256] VanDuzer, BCE v. 1976 Debentureholders, *supra* note 12 at 207, 218, and 228.
[257] *Ibid* at 247-248.
[258] *Ibid*.
[259] *Ibid* at 213. Also, please see the Supreme Court's discussion in *Peoples, BCE*, and *Maple Leaf Foods Inc. v. Schneider Corp*., 1998 ON CA 5121, [1998] 42 OR. 177.
The discussion of a range of reasonable alternatives is vital in this chapter; however, the courts have left the gap open to decide what is a reasonable alternative. The determination of a reasonable alternative will be highly contextual and will be discussed in further depth. To VanDuzer, he is not contradicting himself by stating the court's endorsement of the BJR is a high level of deference to directors and officers while also stating directors' and officers' decisions must lie within a reasonable alternative. To the contrary, he further asserts: "At the end of the day, however, it may matter very little whether, in principle, *BCE* is understood to open the door to non-shareholder stakeholders to argue that the directors have not acted in the best interests of the corporation by treating them unfairly or have defeated their reasonable expectations by doing so because the business judgment rule provides sufficient deference to director and officer decision making that the risk of liability is remote. Taken together, an uncertain standard that varies with the circumstances and is subject to the deference of the business judgment rule reduces director and officer accountability in general" VanDuzer, *supra* note 4, 252. As previously stated, BJR is not discussed in isolation: it is coupled with fiduciary duty. BJR cannot be used as a shield, as the risk of liability is not remote. This is important to differentiate because the conduct and the decisions of boards of directors and officers

Scholars who have endorsed team production theory provide vital perspective of the business judgment rule, a perspective that is in aligned with Canadian case law[260] as will be seen in the next section. The best interest of the corporation is the primary objective; if the directors' and officers' decisions are challenged, they need not to demonstrate that their decision addressed the interest of a specific stakeholder if that is not in line with the best interest of the corporation.

> To earn the protection of the business judgment rule, directors must show that a challenged decision satisfied three requirements: (1) The decision was made "on an informed basis"; (2) the directors acted "in good faith" and; (3) the directors acted "in the honest belief that the action taken was in the best interests of the company.[261]

Those are some of the requirements and criteria. It is important to note that the courts do not limit their deference to the BJR to only those three criteria. The judges have been clear in drawing boundaries that allow for reasonable business discretion in the management of the corporation.

Macintosh argued that the courts have not made it clear whether or not there are certain criteria for the BJR. The court does not specify whether the BJR covers the decision of who to consider, the nature of the consideration given or both.[262] The elements of BJR criteria identified in this chapter are avoidance of a conflict of interest, good faith, reliance upon the advice of an independent committee of directors, and the directors being reasonably informed.[263] This is not much different from the previously mentioned criteria of reasonableness and good faith;[264] rather, they are complementary and form the underlying crux of the BJR.

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are not unlimited. As a result, the risk cannot be said to be remote when there is explicit legislation and common law cases that put checks and balances on the directors and officers.

[260] Blair & Stout, "A Team Production Theory of Corporate Law" *supra* note 5 at 303.

[261] *Ibid*.

[262] Macintosh, *supra* note 5 at 263.

[263] *Ibid* at 266.

[264] Blair & Stout, "A Team Production Theory of Corporate Law" *supra* note 5.

Prior to shifting the discussion to Canadian case law, it is vital to discuss the theoretical underpinning of the business judgment rule in more detail. Judges are not business experts, and, thus, should not be reviewing the merits of decisions on behalf of boards of directors.[265] This is a sentiment that has often been evoked when describing why it is necessary for the courts to grant deference to the business judgment rule to directors and officers, because the expertise lies with directors and not judges. Comparing the expertise of judges to that of directors is a false narrative. Engaging in the following scenario will assist in clarifying this point: Examine a scenario where a company has a factory in a small town and employs a large majority of that town's residents. That plant starts to face financial hardship, and the board of directors is faced with two choices for their plant, either shut it down and relocate to a more cost-effective venue with less operational expenditures or stay at the current location and reduce expenditures in order to improve the financial health of the corporation. Regardless of the option chosen, stakeholders may challenge and dispute the corporation's decision making before the courts. The courts will not decide that option A must be chosen over option B or vice-versa; rather, the courts are the guardian force mechanism determining whether directors have followed the rules in arriving at their decision. The conduct of the directors leading up to the decision will be scrutinized very specifically. The judges are not there to substitute their authority in place of the directors' authority in their decision making; rather, they are there to determine whether the decision making has followed proper procedure. To say that judges are not business experts and as a result are incapable of determining the best decision for the corporation is a false statement. This is not equivalent to similar statements related to medical cases, for example, in which judges are not medical experts:

[265] Bainbridge, "The business judgment rule as abstention doctrine", *supra* note 235 at 37.

> "…why the same judges who decide whether engineers have designed the compressors on jet engines properly, whether the farmer delivered pomegranates conforming to the industry's specifications, and whether the prison system adversely affects the mental states of prisoners cannot decide whether a manager negligently failed to sack a subordinate who made improvident loans." [266]

The logic behind this statement is that judges do not need to be experts in the specific field; their expertise is that they are judges. Directors and officers have the long-term interest of their respective corporations in mind, while judges are there to ensure that the rules of law are properly followed. As a result, because judges are not participants in the market and are not loyal to a certain institution, they are the appropriate body forum to determine inappropriate action in a fierce market. The point is that the judges are not part of the market. By establishing certain boundaries to the deference accorded to directors and officers under the business judgment rule, the judges are there to ensure corrective measures are in place to counter irregularities, and/or breach of the law by corporations. The following section will examine the much discussed boundaries and the framework that directors must not violate in order to be granted deference to the BJR by the courts.

Kerr v. Danier Leather Inc.

Danier made an initial public offering of its shares through a prospectus.[267] The prospectus contained a forecast that included the company's projected results for the fourth quarter of the fiscal year. An internal company analysis prepared before its public offering closed showed that Danier's fourth quarter results were lagging behind its forecast.[268] Danier did not disclose its intra-quarterly results before closing. The appellants, therefore, brought a class proceeding for prospectus misrepresentation under *Subsection* 130(1) of the *Ontario Securities Act*.[269] The trial

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[266] Frank H. Easterbrook and Daniel R. Fischel, "The Economic Structure of Corporate Law" Harvard University Press, 1321.
[267] *Kerr v. Danier Leather Inc.*, 2007 SCC 44, [2007] 3 SCR 331, para 52.
[268] *Ibid*.
[269] *Ibid* at para 32.

judge found Danier liable for statutory misrepresentation. He concluded that the prospectus implied that the forecast was objectively reasonable, both on the date the prospectus was filed and on the date the public offering closed.[270] The poor fourth quarter results were material facts required by *OSA Subsection* 130(1) to be disclosed before closing. The implied representation that the forecast was objectively true, even though it was true on the date the prospectus was filed, was false on the closing date. The respondents invoked the business judgment rule as a defense. The argument of the board of directors of Danier was that the forecasting was objectively reasonable. The issue was not necessarily the judges second-guessing if forecasting was objectively reasonable. Arguably, one of the most important remarks in the case was from Justice Binnie's analysis. He stated the following:

> On the broader legal proposition, however, I agree with the appellants while forecasting is a matter of business judgment, disclosure is a matter of legal obligation. The Business Judgment Rule is a concept well-developed in business decisions but should not be used to qualify or undermine the duty of disclosure…*disclosure requirements under the Act are not to be subordinated to the exercise of business judgment*.[271]

The BJR does not apply because it is *subordinate to explicit statutory duty*. In identifying what is unreasonable and the range or reasonableness or the set parameters, and based on the court's interpretation in *Danier*, the BJR cannot be used to override statutory duty. While the subordination of the BJR to statutory duties might be obvious, it is often underestimated when read conservatively. The application of explicit statutory duties requiring directors and officers to uphold the interests of various stakeholders trumps the BJR deference.

Moreover, in deciding the *Kerr v. Danier Leather Inc.*, the SCC relied on earlier rulings from *Maple Leaf Foods Inc. v. Schneider Corp.* to determine where the BJR can be used. In *Maple Leaf Foods Inc. v. Schneider Corp.*, Justice Weiler summed up the concept of the BJR as follows:

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[270] *Ibid* at para 51.
[271] *Ibid* at para 54-55.

> The law as it has evolved in Ontario and Delaware has the common requirements that the court must be satisfied that the directors have acted reasonably and fairly. 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. As long as the directors have selected one of several reasonable alternatives, deference is accorded to the board's decision; this formulation of deference to the decision of the Board is known as the 'business judgment rule.'[272]

Thus far, two criteria must be met. The first is that the BJR is subordinate to explicit statutory duty, and secondly, the management of a corporation must come to a reasonable decision, not a perfect decision. This involves the management choosing one of several reasonable alternatives by acting reasonably and fairly. More examination of case law will highlight other criteria prior to engaging in an analysis to further draw the boundaries and the framework as set out by the courts.

Peoples Department Store Inc. (Trustee of) v. Wise[273]

The BJR was discussed in reference to deference and the role of the courts in matters of business expertise. The court stated:

> Courts are ill-suited for and should be reluctant to second-guess the application of business expertise to the considerations that are involved in corporate decision making, but they are capable, on the facts of any case, of determining whether an appropriate degree of prudence and diligence was brought to bear in reaching what is claimed to be a reasonable business decision at the time it was made.[274]

This further defines what has been referred to as the boundaries of the "unreasonable." The courts are capable of determining whether an appropriate degree of prudence and diligence has been brought to bear. Did the courts lay out the criteria in determination of the appropriate

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[272] *Maple Leaf Foods Inc. v. Schneider Corp*., *1998 ON CA 5121,* [1998] 42 OR. 177.

[273] In the case of *Peoples*, the court further elaborated on the business judgment rule. Wise Stores Inc. acquired Peoples Department Stores Inc. from Marks and Spencer Canada Inc. The directors of Wise were three brothers who also became the only directors of Peoples. The acquisition was a fully leveraged buyout, but objected to a new inventory procurement policy affecting the inventory purchases of both companies; anything purchased abroad would be purchased by Wise, but domestically would be purchased by Peoples. However, because most of the inventory was purchased from North American suppliers, Wise relied on Peoples' credit. Peoples had greater purchases over time and, after procurement challenges, both corporations filed for bankruptcy. Marks and Spencer alleged that this policy was a breach of the director's duty by Wise because, as creditors of Peoples, M & S did not receive the protection as Wise. The Supreme Court rejected the appeal because it held that there was no fiduciary duty to Peoples and that creditors' rights cannot be acquaintances to shareholder rights even if a corporation is in insolvency. *Peoples*, *supra* note 6 at para 4-28.

[274] *Ibid* at para 67.

degree of prudence and diligence? The answer to this question can be determined in later cases where the courts have assessed the appropriate degree of prudence and diligence. This is in addition to the first two criteria that the BJR is subordinate to statutory duties, and the management of a corporation must come to a reasonable decision, not a perfect decision. What is important to understand is that establishing criteria to determine what is prudent and diligent will not take into consideration the endless possibilities of corporate affairs. This is why it is crucial that the analysis in each case before the court be highly contextual and fact-specific. As a result, defining what is reasonable will be done on a case-by-case basis. It is the unreasonable that draws the boundaries and the limits that directors and officers of each corporation must keep in mind and not overstep.

BCE Inc. v. 1976 Debentureholders

In the case of *BCE Inc. v. 1976 Debentureholders*, the Supreme Court upheld the BJR's deference with the following statement: "The 'business judgment rule' accords deference to a business decision, so long as it lies within a range of reasonable alternatives."[275] In this specific case, Bell Canada was deliberating among three competing bids, and all of the bids required Bell to assume additional debt. Acquiring more debt was inevitable, thus, the debentureholders bond value was also inevitably impacted, since increased debt would reduce the value of the bond. The court also noted, in arguably one of the most important developments of the case, that:

> In considering what is in the best interest of the corporation, directors may look to the interests of, *inter alia*, shareholders, employees, creditors, consumers, governments and the environment to inform their decisions. Courts should give appropriate deference to the business judgment of directors who take into account these ancillary interests, as reflected by the business judgment rule.[276]

[275] *BCE*, *supra* note 6 at para 40, 96-100.
[276] *Ibid* at para 40.

The directors took concrete measures to determine the best decision for the long-term interest of the corporation. This meant that particular stakeholders would benefit at the expense of other stakeholders. In this matter, the debentureholders' interest was compromised to ensure the best deal for the long-term interest of the corporation.[277] The *BCE* case highlights the court's comfort with deference accorded to business decisions made, while, of equal importance, stating that according deference to a business decision must lie within a range of reasonable alternatives.[278] The Supreme Court did not specify what reasonable alternatives allow for deference to the BJR; however, what is *unreasonable* is not taking into consideration the interests of various stakeholders if they align with the long-term best interest of the corporation. The Supreme Court did not engage in setting out specific criteria of what is objectively reasonable in order for the courts to apply the BJR in future cases. Rather this has been done on a case-by-case basis, to allow the courts to examine the specific context. The use of the business judgment rule in the *BCE* case does not translate into it being an abstention doctrine where the courts would not interfere. The courts do allow deference as long as it is reasonable, although the Supreme Court did not engage in setting out criteria for what is reasonable, preferring that it be done case by case.

Holding Inc. v. Vancouver Airport Centre Ltd

Another case that discussed legal requirement is *Sharbern Holding Inc. v. Vancouver Airport Centre Ltd,* post-*BCE*. Similar to the *Kerr v. Danier Leather* case in that both cases are at the heart of securities law, the discussion of the BJR overlaps with that of corporate governance. The Supreme Court examined the test of what constitutes a "material false statement" under securities

[277] *Ibid* at para 99.
[278] *Ibid* at para 40.

statutes. Discussion of the BJR in this case was similar to the discussion in *Kerr v. Danier* in that the courts and legislature decide legal criteria; it is not for the business experts to determine the legal requirements.[279] Justice Rothstein, relying on *Kerr v. Danier Leather Inc.*, stated the following:

> As I have explained, the question of materiality involves the application of a legal standard to a given set of facts. Judges are not less expert than business managers when it comes to the application of a legal standard to a given set of facts; neither do managers' assessments of risk have anything to do with meeting their disclosure obligations. As Justice Binnie observed, '[i]t is for the legislature and the courts, not business management, to set the legal disclosure requirements.'[280]

The legal disclosure requirement is, thus, mandated by the courts, and directors and officers must abide by it. The vital point to extract from this is that there may be confusion about a material statement that has been disclosed in terms of whether it is a business decision or a mandated legal requirement.[281] A diligent director would be aware, but in the day-to-day operations of a corporation, and even over the short- or medium-term of managing corporate affairs, it becomes very complex and hard to separate business decisions from legal requirements. As a result, it is only appropriate to state that the directors' duties have become heightened in the 21st century, with more regulations requiring appropriate navigation by the directors and officers. These cases dealing with the business judgment rule pave the way for the next section to discuss the implications of the BJR coupled with the various theoretical underpinnings as discussed earlier.

Analysis of the Business Judgment Rule

The criteria that have been identified as satisfying the courts and thereby granting deference to the business judgment rule are as follows:

- The business judgment rule is subordinate to statutory duties;

[279] *Kerr v. Danier Leather Inc. supra* note 267 at 54.
[280] *Sharbern Holding Inc. v. Vancouver Airport Centre Ltd.*, 2011 SCC 23, [2011] 2 SCR 175 at para 57.
[281] *Kerr v. Danier Leather Inc. supra* note 267 at 54.

- The management of a corporation must come to a reasonable decision, not a perfect decision;
- The decision must lie within a range of reasonable alternatives. In other words, the decision must be taken within a range of reasonableness; and,
- The courts are capable, on the facts of any case, of determining whether an appropriate degree of prudence and diligence was brought to bear in reaching what is claimed to be a reasonable business decision at the time it was made.

In the context of fiduciary duty that allows for the consideration of multiple stakeholders' interests and as previously highlighted, directors must show that a challenged decision has been made "on an informed basis;" that the directors acted "in good faith;" and the directors acted "in the honest belief that the action taken was in the best interests of the company."[282] As to what is meant by "reasonable alternative," the courts have not answered this question by explicitly setting out the criteria or requirements for reasonable alternatives. By not doing so, the courts have left a space that acknowledges a potential tension between the obligations of directors and officers under the *CBCA*[283] and the business judgment of directors and officers. As a result, the courts will let the tension play out in court and judge on a case-by-case basis. However, the courts have also stated that,

> Deference to the BJR will be granted by the court if directors fulfilled their duty with intentions of the best interest for the corporation; the best interest of the corporation may include the interests of various stakeholders, the employees, creditors, consumers, etc.[284]

Scholars who are in favour of the shareholder primacy model have claimed that directors who focus on the interests of nonshareholder stakeholders are looking after their own self-interests. As a result, the business judgment rule must be examined with the view that directors' objectives are to maximize the wealth of shareholders.[285] Additionally, many of those scholars are uniform in their thinking that the BJR should be viewed in the context of the fiduciary duty of the

[282] Blair & Stout, "A Team Production Theory of Corporate Law" *supra* note 5 at 303.
[283] More specifically under Subsection 122. (1) of *CBCA*.
[284] *BCE*, *supra* note 6 at para 39.
[285] Please see the work of Bainbridge, Director Primacy, *supra* note 5; MacIntosh, *BCE* and *Peoples*' Corporate Law, *supra* note 53; VanDuzer, BCE v. 1976 Debentureholders, *supra* note 12. All three scholars have criticized the vagueness surrounding the discussion of the BJR.

directors and officers as maximizing shareholder wealth. However, when assessing BJR from a team production perspective, the substance of how BJR is viewed and interpreted is changed. The courts can help dispel the deep suspicions regarding whose interests are being looked after, because they are not hesitant to examine directors' conduct.

The BJR is subordinate to explicit statutory duty. The employees under provincial legislation, such as the *Ontario Employment Standards Act*, have avenues to ensure that directors have their considerations under advisement in any decisions that will impact them.[286] The implication of the court's statement that the BJR is subordinate to explicit statutory regulations has a wide impact within various legislations, federally and provincially. Moreover, with the important implication being that directors must abide by all legislation, coupled with the expansion of fiduciary duty to take into account the interests of various stakeholders, it is inappropriate for directors to favour exclusively the shareholder primacy viewpoint. It is even more inappropriate for directors to only look after their own self-interest disguised as looking after the interests of nonshareholder stakeholders. As argued throughout the thesis, in an increasingly interconnected and interdisciplinary society, statutory duties have imposed higher accountability on corporations. Similarly, shareholder primacy is limited by the higher accountability for corporations to disregard the interest of stakeholders' interests. Management of corporations cannot rely on the BJR to protect them from statutory duty. The high level of deference that will protect directors[287] is not without its limit.

In discussing prudence and diligence, the following statement by the courts in *Peoples*, is vital:

> The Courts are capable, on the facts of any case, of determining whether an appropriate degree of prudence

[286] Please see *Ontario Employment Standards Act*, SO 2000, c 41. The following sections are applicable: Sections 11-14, and 17-21.1.
[287] Puri, "Future of Stakeholder Interests in Corporate Governance", *supra* note 12; and VanDuzer, BCE v. 1976 Debentureholders, *supra* note 12.

> and diligence was brought to bear in reaching what is claimed to be a reasonable business decision at the time it was made.[288]

Prudence and diligence can further draw the parameters of where directors and officers may operate and help to counter the notion that the BJR can be used as a shield for directors. R. Lynn Campbell discusses the importance of prudence and the degree of diligence. As Campbell notes,

> The test is not the degree exercised by a very cautious person who meticulously envisions the worst possible scenario, but that of a reasonable prudent person in comparable circumstances… Knowledge is an important factor to be considered when determining whether a director has exercised sound judgment. With respect to prudence, knowledge can be either actual knowledge or the knowledge that the reasonable person would have acquired in comparable circumstances.[289]

Prudence is the exercise of sound judgment. When the courts look at business decisions, they are looking for diligent people making decisions that are acceptable by reasonableness and objectivity,[290] and the courts are willing to determine this on a case-by-case basis. As a result, in today's highly accessible world of information, directors must face the reality of more responsibility and maintain awareness of developing rules and regulations. The high level of deference has been overestimated. The argument is the boundaries of the courts granting deference were identified, and of equal importance it has been demonstrated that the boundaries are not finite. This means that the courts can create additional criteria; they are willing to let the use of BJR be challenged in the courts. What has been demonstrated in this chapter is that the high level of deference cannot, and will not protect the directors if they only maximize the wealth of the shareholders without taking into consideration the interests of other stakeholders in the corporation.

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[288] *Peoples, supra* note 6 at para 57.
[289] *R. L. Campbell, "Directors' Diligence under the Income Tax Act" (1989) 16 Can. Bus. LJ* at 485.
[290] *Peoples*, *supra* note 6 at para 64.

Conclusion

> I appreciate that it would be a breach of their duty for directors to disregard entirely the interests of a company's shareholders in order to confer a benefit on its employees: *Parke v Daily News Ltd.* But if they observe a decent respect for other interests lying beyond those of the company's shareholders in the strict sense, that will not, in my view, leave directors open to the charge that they have failed in their fiduciary duty to the company.[291] [Justice Berger, *Teck Corp. v Millar*]

The purpose of this project is to demonstrate that the shareholder primacy model is no longer feasible in Canada. The findings in this thesis reveal that shareholder primacy runs counter to the duties imposed on directors by regulatory bodies, the judiciary, and explicit legislative statutory duties. The impact of this means that directors must rethink their stance on maximizing the wealth of shareholders if it disregards the interest of other stakeholders. Business decision-making must occur in a realm where multiple stakeholders' interests are taken into account. The BJR is unable to shield directors from disregarding the interest of multiple stakeholders. The courts will not shy away from examining how boards of directors reached their decisions. As a result, they must embrace the team production theory model. This does not necessarily mean that maximizing the wealth of shareholders can no longer be an objective of the board of directors. Rather, this means that there must be a rethinking of how to best approach the maximization of shareholders' wealth while also considering the interests of multiple stakeholders of the corporation.

The SCC decisions in *Peoples*, and *BCE* opened the path in relegating the shareholder primacy model to allow for the team production model to be embraced by the board of directors. Fiduciary duty, as owed to the corporation, will be stronger if it is not owed exclusively to a certain stakeholder. This allows for explicit statutes as imposed on directors to parallel their

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291 *Peoples, supra* note 6 at para 42 citing *Teck Corp. v Millar,* [1972] 33 DLR (3d) 288. While the case of *Tech Corp v Millar* was decided in 1972, the concept of multiple stakeholders, as recipient of the fiduciary duty in Canada was fully confirmed in 2008 by the case of *BCE Inc. v 1976 Debentureholders*, 2008 SCC 69, [2008] 3 SCR 560.

fiduciary responsibility. This means that if shareholders were the only beneficiary of fiduciary duty, it would run counter to explicit statutory duties.

In this thesis, it has been established that explicit statutory duties, including stronger environmental, consumer and creditor protection, as well as better employment and labour standards legally require directors to consider multiple stakeholders' interests. The analysis in the chapter three demonstrates that explicit statutory duties are superior to the BJR. As a result, directors can no longer operate with the mindset that the BJR will afford them protection to disregard the interest of multiple stakeholders in allegations of breach of their fiduciary duty. The impact of this reveal is that the shareholder primacy model is no longer feasible in Canada. Boards of Directors must embrace elements of team production theory. Maximizing the wealth of the shareholders can occur, however, but this must be done while embracing the interest of multiple stakeholders. While the intention is to disprove shareholder primacy, advancing team production theory is crucial as the normative alternative to shareholder primacy. Future research must focus on continuing to articulate and advance team production theory, although to get there, it must be proven that shareholder primacy is no longer feasible. This is one of the objectives of this thesis. Moreover, the articulation of the BJR can positively contribute to the body of literature due to the low turnout of judiciary analysis of the BJR. Empirical studies would assist in advancing the BJR as an important concept to help clarify directors' roles and duties.

Our society is increasingly interconnected. The information that is readily available heightens the accountability of corporations to avoid acting negligently. The proposition is not that corporations are inherently negligent; rather, it is that they ought to be good corporate citizens that are considerate of the interests of its stakeholders. Owing exclusive fiduciary duty to consider the interests of only the shareholder is no longer feasible. Fiduciary duty has been consistently owed to the corporation, but it shifted away from the consideration of exclusively the shareholders' interests in profit maximization to a broader consideration that includes the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment and society at large.

The first chapter examined the history of the shareholder primacy model whereby fiduciary duty has been narrowly interpreted to favour shareholders exclusively and make the normative objective of the board of directors to maximize the wealth of shareholders. Examining the arguments made in favour of narrow interpretation of fiduciary duty revealed that many of the arguments made were economic, and while in the 19th and early 20th centuries, the shareholder primacy model would have worked, the rules and regulations were not as developed as they are in the 21st century. It has been easier for the boards of directors to singularly focus on the interest of shareholders as they owe fiduciary responsibility to the corporation. As argued throughout this thesis, the development of capitalism alongside the law with its robust rules and regulations, an evolution has occurred whereby other actors have emerged as vital stakeholders in the corporation. Employees have become more vocal in their rights, and human rights laws have emerged as important fundamental rights. World events have strengthened this evolution. Post-World War II, the Universal Declaration of Human Rights became globally recognized, and large corporations in today's society have accepted and made respecting human rights part of their mandate. This is seen in the emergence of employees recognizing their rights and vocal consumers who will not accept unethical behavior by corporations. Society no longer accepts blatant damage to the environment; creditors ensure that corporations do not engage in risky investment behaviours, and governments protect the pensions of employees. All of those developments occurred in the latter half of the 20th century and the beginning of the 21st century.

With this emergence, it is only right that the fiduciary duty as owed to the corporation be expanded to allow for the consideration of multiple stakeholders' interests and not exclusively the shareholders.

The second chapter demonstrates the shift from shareholder primacy toward team production theory. The court in *Teck Corp. v Millar* stated,

> A classical theory that once was unchallengeable must yield to the facts of modern life. In fact, of course, it has. If today the directors of a company were to consider the interests of its employees no one would argue that in doing so they were not acting *bona fide* in the interests of the company itself.

The classical theory referred to above is shareholder primacy. Increasing rules and regulations, stronger labour, workplace safety, environmental, and consumer legislation, already require management of corporations to ensure stakeholders' interests are not violated or neglected. Extending fiduciary duty to include consideration of the interests of those stakeholders, will work with the spirit of heightened rules and regulations. Calls to adopt legislation that restore fiduciary duty to shareholders only are not realistic and would be counter to the current corporate governance state in Canada.

The business judgment rule is a concept that is not intended to protect directors for not taking into consideration the interests of the corporation's stakeholders. Arguments that state directors must take comfort in knowing the courts will grant a high level of deference are not only misguided, they are simply false. To be granted deference, the courts will determine if the directors have met the required criteria. These criteria will be determined on a case-by-case basis, each instance being highly contextual and based on the facts of each case. By examining previous Supreme Court Appellate courts, it has been advanced that BJR is not a shield for directors to avoid fiduciary duties. Rather, both concepts are complementary to each other, which will assist in cementing the shift away from shareholder primacy toward a broader interpretation of fiduciary duty, one that is owed to the corporation but allows for the consideration of multiple stakeholders.

The corporations' role in society does matter. No longer are their actions isolated. The financial crisis in 2008 and its impact on the socioeconomic fabric in our society demonstrate the negative consequences, massive job layoffs, which started a negative spiral. Citizens expect their respective governments to ensure safety and protection. This has been especially heightened after 9/11. It is only right that increasing rules and regulations be enacted to ensure a repeat of the 2008 financial crisis or any other detrimental conduct by corporations does not occur. Extending the fiduciary duty to include multiple stakeholders was the right step by the SCC. However, what the SCC did not provide in *BCE* is clear and concise practical guidance to the management of the corporation on how to extend the fiduciary duty to include those stakeholders. One objective of this thesis was to fulfill that role. More importantly, in contributing to the academic discussion of corporate governance, this thesis' main purpose is to provide an analysis of the appropriate corporate governance model in Canada. Post-*BCE,* the SCC rejected shareholder primacy. Fiduciary duty is thus owed to a corporation's long-term interests, which has significantly allowed the emergence of an interdisciplinary model in which shareholder primacy is relegated in favour of the interest of multi-stakeholders.

Future research will benefit from assessing regulatory bodies that focus on a specific stakeholder. For example, in the telecommunication industry, the Canadian Radio-television and Telecommunications Commission is an administrative tribunal that regulates corporations to ensure stronger protection for consumers. Examining the imposed regulations that require improved services for consumers, for example, on large corporations in the telecommunication industry, such as TELUS, Rogers, and Bell Canada, will help in cementing team production theory and demonstrate that corporations have more than one vital stakeholder. The shareholders of any corporation are important stakeholders, and their investment is what enables the corporation to grow. However, the consumers, in the case of telecommunication industry, are also important as the objective of these large companies is to provide telecommunication services to consumers.

Future research must continue down the path of attempting to improve corporate governance in Canada. Assessing and analysing the fiduciary duty and the corporation's relationship with each individual stakeholder will build on the foundations established in this thesis. Certainty and predictability in the law are fundamental for better conduct by corporations. Corporations are responsible citizens that must operate within the rules and regulations on which society has collectively agreed.

Important questions that should be posed in future cases include: To what extent can the legal system play a vital role in shifting away from the shareholder primacy model? To what extent can the legal order change the business behaviour of boards of directors? Changing the mindset of directors from solely maximizing the wealth of shareholders can be achieved through an interdisciplinary model, where the political order must also play a role. Political pressure to enact reform will aid the legal order. However, future research would be better able to examine the extent of the legal order in changing business behaviour.

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