The BCE Blunder: An Argument in Favour of Shareholder Wealth Maximization in the Change of Control Context

by

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Abstract

The traditional approach to corporate governance in Canada has centered on shareholders. This model of governance is commonly referred to as shareholder primacy. The shareholder primacy model has recently been rejected by the Supreme Court of Canada in *Peoples v. Wise* and *BCE v. 1976 Debentureholders*.

This paper will be argued that directors should be required to focus exclusively on increasing shareholder value in the change of control context. It is within the change of control context that shareholders most require fiduciary protection. In addition, the shareholder primacy rule provides an enforceable standard for evaluating the actions of directors. As stakeholders have a variety of mechanisms to ensure that their interests are not disregarded, they are not in need of fiduciary protection. In contrast, shareholders face greater risks, which validate a need to be protected by an exclusive fiduciary duty in the change of control context.
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Introduction

The structure of corporate law has always equated the best interest of the corporation with that of the shareholders. Shareholders have the right to elect directors, approve fundamental transactions and bring derivative suits on behalf of the corporation. Other corporate stakeholders – employees, creditors, customers, suppliers, the local community, etc. – are left to contractual remedies to protect their interests. This shareholder focused model of corporate law is referred to as shareholder primacy.

It is within directors’ fiduciary duties that shareholder primacy finds its most direct expression. Directors play a very important role in corporate decision-making. The board of directors is the highest governing authority within the management structure of any company. It is the board’s job to select, evaluate, and approve appropriate compensation for the company's chief executive officer, approve the company's financial statements, pay dividends and make recommendations on change of control transactions. Under shareholder primacy, directors’ fiduciary duties require them to act in “the best interest of shareholders” when making these decisions. Although directors may consider the interests of other corporate constituents they are unable to act in a way that has a negative impact on shareholders.

Stakeholder theory represents a competing regime to shareholder primacy. Stakeholder theory contemplates a broader social role for corporations. Stakeholder theorists argue that unilateral focus on shareholder wealth fails to recognize that groups other than shareholders are integral to the success of the corporation. As such, directors should contemplate the interest of stakeholders when making decisions.
Scholars touting the merits of each theory have been involved in a fierce debate for over 80 years.\(^1\) Traditionally, shareholder primacy has been the dominant model of Canadian corporate law. However, in recent years two influential Supreme Court of Canada decisions have drastically changed the content of fiduciary duties in Canada: *Peoples v Wise*\(^2\) and *BCE v. 1976 Debentureholders*\(^3\). These decisions permit directors to consider the interests of all stakeholders (not just shareholders) when making decisions. The purpose of this paper is to analyze the two Supreme Court decisions.

This paper will be broken into three sections. Section I will examine case law and legislation outlining the content of fiduciary duties in Canada. Section II will critique the approach to director fiduciary duties outlined by the Supreme Court in *Peoples* and *BCE*. Section III will argue that fiduciary duties should require directors to maximize shareholder value in the change of control context. The paper will conclude by questioning the role of the Supreme Court of Canada in making fundamental changes to corporate law.

**I. Directors’ Fiduciary Duties: Who’s Best Interest?**

Although traditionally a common law duty, Canadian directors’ fiduciary duties are currently set out in s. 122 of the *Canada Business Corporations Act*.\(^4\) The section provides that “every director and officer of a corporation in exercising their powers and discharging their duties shall act honestly and in good faith with a view to the best interests of the corporation.”\(^5\)

Generally, the purpose of a directors’ fiduciary duty is to ensure that directors carry out their

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\(^1\) The debate can be traced back to Dodd and Berle. See, Adolf Berle, “Corporate Powers in Trust” (1931) 44 Harv. L.R. 1049 [*Berle*]; Edwin Dodd, “For Whom Are Corporate Managers Trustees?” (1931) 45 Harv. L.R. 1145 [*Dodd*]; Adolf Berle, “For Whom Are Corporate Managers Trustees: A Note” (1932) 45 Harv. L.R. 1365.

\(^2\) *Peoples v Wise*, 2004 SCC 68 [*Peoples*].

\(^3\) 2008 SCC 68 [*BCE*].

\(^4\) [1985] c. 44 [*CBCA*]. Canadian provincial corporate law statutes vary slightly with regard to directors’ fiduciary duties. This paper will focus on the duty found in s. 122 of the CBCA.

responsibilities with the utmost good faith, that they do not act in their own interest and that they are loyal to the corporation when executing their roles and responsibilities.\(^6\)

This section of the paper will trace how courts have interpreted the “best interest of the corporation” standard. Part A examines the origin and operation of the traditional approach which equated the best interest of the corporation with that of shareholders. Part B examines the change of control context, an area where courts have been quite strict in requiring directors to maximize shareholder value. Finally, Part C examines how two recent Supreme Court of Canada decisions have drastically altered the traditional fiduciary duty.

**A. The Traditional Approach: Shareholder Interests as Paramount**

The current statutory fiduciary duty, which requires that directors act in the “best interest of the corporation”, traces back to a comprehensive report examining corporate law in Canada undertaken by the Dickerson Committee.\(^7\) By suggesting such a wide and ambiguous provision, the Dickerson Committee implicitly contemplated the involvement of courts in fleshing out the content of director’s fiduciary duties.\(^8\) However, courts were not left without any guidance. At the time the CBCA was amended there existed a substantial body of common law that addressed the meaning of “best interest of the corporation.”

The traditional approach to directors’ fiduciary duties equated the best interest of the corporation with the best interest of shareholders. This view was largely grounded in the notion

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\(^6\) Harris et al., *Cases, Materials and Notes on Partnerships and Canadian Business Corporations*, 4\(^{\text{th}}\) ed. (Toronto: Thomson Carswell, 2004).


\(^8\) See Mohamed Khimji, “Peoples v. Wise – Conflating Directors Duties, Oppression, and Stakeholder Protection” (2006) 39 U.B.C. L. Rev. 209 at 212 [Khimji]. (Khimji also suggests that the duty was set up in such a way as to accommodate “evolutions in the law to reflect shifts in attitudes and values” at 212).
that shareholders owned the corporation due to their capital contribution.\textsuperscript{9} One of the first cases to articulate the position was \textit{Hutton v. West Cork Railway Company}\textsuperscript{10} in 1883. In the seminal judgment, Bowen J. pronounced that “the law does not say that there are no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company” and the company means the shareholders.\textsuperscript{11}

The shareholder focused view of the corporation was adopted less than 40 years later in the now infamous case of \textit{Dodge v Ford Motor Co.}\textsuperscript{12} In \textit{Dodge}, shareholders’ complained that directors breached their fiduciary duty when they decide to allocate corporate profits to lowering the cost of cars and increasing employment opportunities within the community rather than paying out dividends. Examining the obligation of directors the court noted that:

\begin{quote}
A business corporation is organized and carried on primarily for the profit of stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end and does not extend to a change in the end itself, to the reduction of profits or the non-distribution of profits among stockholders in order to devote them to other purposes.\textsuperscript{13}
\end{quote}

The statement is largely accepted as the traditional common law position with respect to the definition of “best interest of the corporation”. The duty required directors to manage the corporation with a view to promoting the interests of shareholders.\textsuperscript{14} The position is now commonly referred to as shareholder primacy or shareholder wealth maximization.

In practice the severity of a strict shareholder primacy rule has been curtailed through other corporate law principles. For example, the business judgment rule has played an important

\begin{footnotesize}
\textsuperscript{10} (1883), 23 Ch. D. 654 [\textit{Hutton}].
\textsuperscript{11} Ibid.
\textsuperscript{12} (1919) 204 Mich. 459 at 684, 170 N.W. 668 [\textit{Dodge}].
\textsuperscript{13} Ibid [Emphasis added].
\textsuperscript{14} Contra Gordon Smith, "The Shareholder Primacy Norm" (1998) 23 J. of Corp. L. 277 (Smith argues that shareholder primacy was originally introduced to resolve disputes between majority and minority shareholders, not to place the interests of shareholders above stakeholders.)
\end{footnotesize}
role in expanding director discretion to allow for consideration of corporate constituents other than shareholders. The rule developed as a result of courts reluctance to interfere *ex post* with board decisions. Given the difficult nature of these types of determinations and the potential for hindsight bias, courts have given deference to boards provided they have acted in good faith and on a reasonably informed basis. The impact of the business judgment rule has been to insulate many day-to-day board decisions from court scrutiny. As noted by Iacobucci “[b]usiness judgment deference gives corporate decision-makers wide discretion to make decisions that may in fact advance the interest of one group of stakeholders over another regardless of the precise formulation of the fiduciary duty.”

In addition, corporations have long been involved in donating to charity. In 2000, corporations made over ten billion dollars in contributions.\(^\text{16}\) Interpreted strictly, shareholder primacy would not allow for such donations as they relocate wealth from shareholders to other groups. However, the common law has developed a body of case law permitting corporate donations provided there is an indirect benefit to the corporation.\(^\text{17}\) The ability of corporations to give to charity is another example of how shareholder primacy has been diluted through different corporate law rules.

**B. Obligation to Maximize Shareholder Value in the Change of Control Context**

Although shareholder primacy has not been strictly enforced with regard to many day-to-day corporate decisions, one area where it has remained relatively stringent is in the change of control context. A corporate change of control involves transactions where shareholders lose

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\(^{17}\) See, *Evans v Brunner, Mond and Co Ltd* [1921] 1 Ch 359.
control of the corporation or the corporation ceases to exist.\textsuperscript{18} The most common change of control transaction is the sale of a corporation.

The thrust of Canadian jurisprudence has required directors involved in control transaction to focus on maximizing shareholder value.\textsuperscript{19} In this respect, Canadian law has been heavily influenced by American corporate law. The duty to maximize shareholder value in the United States was articulated in \textit{Revlon v. MacAndrews & Forbes Holdings}.\textsuperscript{20} In that case, the Delaware Supreme Court found that once the sale of a company is inevitable, a board has an obligation to maximize shareholder value through holding an auction.\textsuperscript{21} The requirement is referred to colloquially as the “Revlon rule”.

The main justification for such a stringent rule is based on the inherent conflict of interest director’s face when involved in control transactions.\textsuperscript{22} Where a corporation changes ownership directors confront the possibility that their position will be terminated. As such, there is a concern that directors will act in their own interest. The courts concern over self-interested directors was outlined by Moore J. in \textit{Unocal Corp. v. Mesa Petroleum Co.} commenting that in the takeover context there is an “omnipresent spectre that a board may be acting primarily in its

\begin{itemize}
\item \textsuperscript{18} Mohammad Fadel, “BCE and the Long Shadow of American Corporate Law” (2009) 48 C.B.L.J. 190 at 201.
\item \textsuperscript{19} There is some debate on the issue. See Darcy L. MacPherson, “The Supreme Court Restates Directors’ Fiduciary Duty – A Comment on \textit{Peoples Department Store v. Wise} (2005) 43 Alta. L. Rev. 383 (“[I]t is clear that prior to Wise, the weight of Canadian authority on the subject equated ‘the best interests of the corporation’ with ‘the best interests of shareholders’,” at 390) [MacPherson]. Compare Ian Lee “Peoples Department Stores v. Wise and the ‘Best Interest of the Corporation’” (2004) 41 Can. Bus. L.J. 212 [Lee] (“The proposition that the directors may not give preference to the sectional interest of one group of shareholders at the expense of the other does not entail the proposition that only the interests of shareholders are relevant” at 216) and Colin Feasby “Bondholders and Barbarians: BCE and The Supreme Court’s New View on Directors’ Duties” \textit{The Annual Review of Civil Litigation} (Toronto: Thomson Carswell, 2009) [Feasby] (“before BCE, it was impossible to know whether courts intended to enforce the shareholder primacy norm in the context of change of control transactions” at 97).
\item \textsuperscript{20} \textit{Revlon v. MacAndrews & Forbes Holdings}, 506 A. 2d 173 (Del. S.C. 1985) [Revlon].
\item \textsuperscript{21} \textit{Ibid.} (“The duty of the board had thus changed from the preservation of Revlon as a corporate entity to the maximization of the company’s value at a sale for the stockholder’s benefit. This significantly altered the board’s responsibilities...the directors’ role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for stockholders at a sale of the company,” at 12 [Emphasis added]).
\item \textsuperscript{22} A conflict of interest doesn’t require an actual conflict but only the appearance of a conflict.
\end{itemize}
own interests, rather than those of the corporation and its shareholders.”

By requiring directors to focus on the narrow mandate of maximizing shareholder value, the ability of a director to act in a self-interested manner is severely curtailed.

As in many other situations, developments south of the border did not go unnoticed in Canada. Canadian courts confronted with issues of directors’ fiduciary duties in the change of control context naturally looked to the extensive body of American fiduciary law. The initial cases adopted a similarly shareholder centric approach to that found in the United States.

In *CW Shareholdings Inc. v. WIC Western International Communication Ltd.*, the Ontario Court of Justice embraced the Revlon rule. Blair J. noted that directors have a duty “to act in the best interest of the shareholders as a whole and to take active reasonable steps to maximize shareholder value by conducting an auction.” He went on to acknowledge the unavoidable conflict of interest that directors find themselves in when faced with a hostile takeover bid and advised that “retaining independent legal advice and financial advisors, and the establishment of independent or special directors” are additional responses to director conflict of interest.

In *Pente Investment Management Ltd. v. Schneider Corp.* the Ontario Court of Appeal had the opportunity to comment on directors’ fiduciary duties in the change of control context. The case involved an interesting set of facts where a controlling shareholder (the Schneider family) had the unilateral ability to veto any takeover bid made for Schneider Corp. When the company decided that it was time to sell the board received two main offers: one valued at $29 per share, the other at $25 per share. The Schneider family indicated that it would only accept the

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25 *Ibid* at 769.

bid valued at $25 per share as it provided protection for employees in addition to certain tax benefits. The Schneider board then recommended the remaining shareholders accept the $25 bid. A group of shareholders claimed that the board breached their fiduciary duty in recommending the lower bid.

Weiler J. rejected the shareholders’ argument and found that the process employed by the board was reasonable. He stated that “the fact that alternative transactions were rejected by the directors is irrelevant unless it can be shown that a particular alternative was definitely available and clearly more beneficial to the company than the chosen transaction.” The position takes the sensible approach of placing some limits on what is expected of directors when pursuing shareholder wealth.

With regard to the fiduciary obligation of a board in the change of control context, Weiler J. was of the opinion that directors are under an obligation to obtain “the best value reasonably available to shareholders in the circumstances.” Although the court went on to reject the decision in *Revlon*, it is likely that the rejection was aimed at the procedural requirement of holding an auction rather than the obligation to maximize shareholder value. Weiler J. noted that an auction is just one way to minimize director conflict of interest during change of control transactions:

If a board of directors has acted on the advice of a committee composed of persons having no conflict of interest, and that committee has acted independently, in good faith, and made an informed recommendation as to the best available value available to shareholders in the circumstances, the business judgment rule applies.

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27 Pente, supra note 26 at 62.
28 Ibid at 62.
29 Ibid (The court noted that: “In Ontario, an auction need not be held every time there is a change in control of a company. An auction is merely one way to prevent the conflicts of interest that may arise when there is a change of control by requiring that directors act in a neutral manner toward a number of bidders...the obligation of directors when there is a bid for change of control is an obligation to seek the best value reasonably available to shareholders in the circumstances. This is a more flexible standard.” [Emphasis added])
30 Pente, supra note 26 at 38.
More recently, the Ontario Court of Appeal revisited the question of director duties in the change of control context in *Ventas Inc. v. Sunrise Senior Living Real Estate Investment Trust*. The court reiterated the shareholder focused approach to the change of control context stating “[t]here is no doubt that the directors of a corporation that is the target of a takeover bid...has a duty to maximize shareholder (or unit holder) value in the process...”\(^{31}\)

**C. The Current Position: Consideration Outside of Shareholders**

As the case law above indicates there is a strong line of cases taking the position that director’s duties in the change of control context require that they maximize shareholder value. However, not all courts were in agreement. The discussion below examines a string of cases taking the position that director’s duties permit contemplation of non-shareholder interests. The most important of which are two Supreme Court of Canada decisions that explicitly reject the idea that directors’ fiduciary duties require them to focus exclusively on maximizing shareholder value in the change of control context.

The case of *Tech Corp. Limited v. Millar* represents the first occasion that a court stated that directors may consider interests outside of shareholders in the change of control context. Despite being a lower court decision, the case is a watershed in Canadian takeover jurisprudence. When speaking to defensive measures aimed at stopping a hostile takeover bid Berger J. noted:

> I appreciate that it would be a breach of their duty for directors to disregard entirely the interest of a company’s shareholder in order to confer a benefit on its employees... But if they observe a decent respect for other interest lying beyond those of the company’s shareholder 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.\(^{32}\)

\(^{31}\) *Ventas Inc. v. Sunrise Senior Living Real Estate Investment Trust* (21007), 85 O.R. (3d) 354 (C.A.) at para. 34.  
Commentators have argued that *Tech* asserts the position that in Canada courts have recognized that the fiduciary duty of directors contemplates considerations of corporate constituents in addition to shareholders.\(^{33}\) Others have argued that the comments made by Berger J. are obiter\(^ {34}\) and that the comment was not intended to reject shareholder primacy.\(^ {35}\)

The Supreme Court of Canada took the opportunity to remark on the decision in *Tech* and their conception of director’s fiduciary duties in the case of *Peoples v Wise*.\(^ {36}\) Although the case did not involve a change of control transaction, the court set down their position on the fiduciary duties of directors more broadly.

The case arose as the result of the 1992 Wise stores acquisition of Peoples department stores. Within two years Peoples’ business began to fall on tough times. In order to alleviate cost concerns the Wise brothers (directors and officers of both companies) decided to implement an inventory procurement policy.\(^ {37}\) Rather than purchasing separate inventory, the policy required inventory to be purchased by Peoples and subsequently be given to Wise on credit. The new inventory policy was ultimately unsuccessful and Peoples was forced into bankruptcy. At the time, Wise owed Peoples $18 million for unpaid inventory.\(^ {38}\) The Trustee in Bankruptcy for Peoples alleged that the Wise brothers had breached their fiduciary duty to Peoples by placing the interests of Wise creditors over Peoples creditors.\(^ {39}\)

When the case reached the Supreme Court of Canada, the court framed the issue to be determined as whether “directors owe a fiduciary duty to the corporation’s creditors comparable

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33 Feasby, supra note 19 at 97.
34 Wayne Gray, “*Peoples v. Wise* and *Dylex*: Identifying Stakeholder Interests Upon or Near Corporate Insolvency – Stasis or Pragmatism?” (2003), 39 C.B.L.J. 242 at 243.
35 MacPherson, supra note 19 at 391.
36 It has been argued that the Supreme Court was not obligated to take a position on the issue at all. See, Khimji, supra note 8.
37 Peoples, supra note 2 at 15.
38 Ibid at 20.
39 Ibid at 25.
to the statutory duty owed to the corporation.”⁴⁰ The court rejected the argument that directors owe a fiduciary duty to creditors and went further to say that directors do not owe a fiduciary duty to any constituent making up the corporation. The court noted that:

[I]t is clear that the phrase “best interest of the corporation” should be read not simply as the “best interest of shareholders”. From an economic perspective, the “best interest of the corporation” means maximizing the value of the corporation. However, the courts have long recognized that various other factors may be relevant in determining what directors should consider in soundly managing with a view to the best interest of the corporation.⁴¹

The court rejected shareholder primacy, finding that directors may consider interests outside of shareholders when making decisions. Rather than simply focus on shareholder value, a director is required to act in the best interest of the corporation. In doing so they may consider a variety of groups including, intra alia, shareholders, employees, suppliers, creditors, consumers, governments and the environment.⁴² Directors should strive to create “a ‘better’ corporation, and not to favour the interest of any one group of stakeholders.”⁴³

The Peoples decision had a significant impact on Canadian corporate law. The Supreme Court put to rest any question of whether shareholder primacy governed fiduciary duties. The court specifically noted that directors may consider interests outside of shareholders. However, Peoples seemed to raise more questions than answers. The decision conflicted directly with previous case law that required directors to maximize shareholder value in the change of control context. It remained unclear whether directors were required to consider the interest of stakeholders and if directors could make a decision that favoured stakeholders over shareholders.

In BCE v. 1976 Debentureholders the Supreme Court was given the opportunity to examine some of the questions that emerged from their decision in Peoples. BCE involved a $52

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⁴⁰ Peoples, supra note 2 at 1.
⁴¹ Ibid at 42. [Emphasis added].
⁴² Ibid.
⁴³ Ibid at 47.
billion transaction, the largest leverage buy-out in Canadian history, to be effected by plan of arrangement under the CBCA. The transaction came about when BCE’s board decided to put the company in play. The board established a special committee which was charged with the objective of “maximizing the interest of shareholders while respecting the rights of bondholders.” The committee set up an auction process that elicited three bids all of which were structured as leveraged buy-outs.

The highest bid was made by a consortium led by Ontario Teachers’ Pension Plan and represented a 40% premium to the closing price of BCE shares. Under the arrangement, Bell Canada, a wholly owned subsidiary of BCE, would be required to guarantee approximately $30 billion of new debt. A majority of 97% of shareholders approved the arrangement.

The increased debt load of Bell Canada resulted in its debentures being downgraded below investment grade and a subsequent drop in trading value by approximately 20%. In response, the debentureholders launched a challenge claiming the transaction was oppressive under s. 241 of the CBCA and not fair and reasonable under s. 192 of the CBCA.

At trial, the Quebec Superior Court dismissed the oppression claim and approved the transaction as fair and reasonable. The court reasoned that in these circumstances the board had acted reasonably in determining that their fiduciary duty required them to maximize shareholder

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45 *BCE Trial Oppression*, supra note 44 at 52.

46 *Ibid* at 89.

47 *BCE supra*, note 3 at 19.


49 *BCE Trial Oppression*, supra note 44.
The reasonable expectation of the bondholders was restricted to the contractual agreements in place.\(^5\)

The Quebec Court of Appeal reversed the trial court’s ruling and refused to approve the transaction.\(^5\) The court, relying on Peoples, rejected the position that the board had an obligation to maximize shareholder value.\(^5\) They then went on to state that the board was required to consider the interest and reasonable expectations of the bondholders. The court was of the opinion that statements made in offering materials and public reports created a reasonable expectation among debentureholders that BCE would structure the deal in a way that did not negatively impact their financial interests.\(^5\) As BCE failed to produce any evidence that they attempted to accommodate the debentureholders’ reasonable expectation, the court was unable to find the arrangement to be fair and reasonable.\(^5\)

The Supreme Court of Canada overturned the Quebec Court of Appeal decision. The court determined that the plan of arrangement was fair and reasonable and that BCE did not act oppressively towards debentureholders. The court found the board had considered the debentureholders’ reasonable expectation and acted reasonably in accepting the highest offer.\(^5\)

The unanimous court again took the opportunity to comment on directors’ fiduciary duties and how those duties interact with the oppression remedy. The following sub-sections outline the approach the BCE court took to fiduciary duties.

i. **What Does the Fiduciary Duty Entail?**

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\(^5\) BCE Trial Oppression, supra note 133.
\(^5\) BCE Inc., Re (2008), 43 B.L.R. (4th) 157 (Que. C.A.) [BCE QCA].
\(^5\) Ibid at 99-100.
\(^5\) Ibid at 106.
\(^5\) Ibid at 117.
\(^5\) BCE, supra note 3 at 113.
The court noted that a directors’ fiduciary duty is a “broad, contextual concept”. The content of the duty will vary depending on the situation at hand and there are no absolute rules. The duty is mandatory and, at minimum, it requires directors to ensure that the corporation meets its statutory obligations.

ii. **To Who Is the Duty Owed?**

The court affirmed *Peoples* and noted that the fiduciary duty is owed to the corporation. Directors are required to act in the best interest of the corporation, viewed as a good corporate citizen. No one particular set of interests is paramount. The corporation’s interests are not synonymous with the interests of shareholders or any other stakeholder. They noted that, when the corporation is a going concern the duty looks to the long term interest of the corporation.

iii. **Who May be Considered?**

Although not mandatory, in certain circumstances it may be appropriate to consider the interests of shareholders and other corporate stakeholders. Affirming *Peoples* the court stated that the boards may look to the interests of, *inter alia*, shareholders, employees, creditors, consumers, government and the environment to inform their decisions. Courts are to give appropriate deference to consideration of ancillary interests under the business judgment rule. Thus, provided that it is “within a range of reasonable alternatives” to “take into account these ancillary interests” courts will not scrutinize a board’s decision.

iv. **Who Must Be Considered?**

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56 *BCE, supra* note 3 at 66.
57 *Ibid* at 37.
58 *Ibid* at 66.
59 *Ibid* at 38.
60 *Ibid* at 39.
61 *Ibid*.
63 *Ibid*. 
In certain circumstances boards will be obligated to consider stakeholder interests. The obligation arises under the oppression remedy which requires directors to consider the reasonable expectations of all stakeholders. When determining whether a stakeholder has a reasonable expectation, factors such as commercial practice, the size, nature and structure of the corporation, the relationship between the parties, past practice, the failure to negotiate protection, agreements and representations and the fair resolution of conflicting interests are relevant considerations.\textsuperscript{64}

A fundamental component of a stakeholder’s reasonable expectation includes being treated equitably and fairly.\textsuperscript{65} In addition, stakeholders’ reasonable expectation is that directors will act in the best interest of the corporation.\textsuperscript{66} Reasonable expectations are not confined to legal interests.\textsuperscript{67} When making a decision that impacts a given stakeholder, a board will be obligated to consider the reasonable expectations of the stakeholder. However, not every reasonable expectation gives rise to oppression under s. 241. In addition to showing a reasonable expectation, a claimant must establish that the disregard of the reasonable expectation amounts to oppression, unfair prejudice, or unfair disregard in order to make a successful oppression remedy claim.

v. **Where Interests Conflict?**

The court recognized that in certain circumstances the interests of corporate constituents may conflict.\textsuperscript{68} Where interests conflict, directors are to resolve them according to their fiduciary duty to act in the best interest of the corporation, viewed as a good corporate citizen.\textsuperscript{69} The

\begin{flushleft}
\textsuperscript{64} BCE, supra note 3 at 106.
\textsuperscript{65} Ibid at 70.
\textsuperscript{66} Ibid at 66.
\textsuperscript{67} Ibid at 102.
\textsuperscript{68} Ibid at 64.
\textsuperscript{69} Ibid at 81.
\end{flushleft}
oppression cases indicate that directors have a duty to treat stakeholders affected by corporate
decision-making fairly and equitably.\textsuperscript{70} However, provided that a decision is in a range of
reasonableness, it will be protected under the business judgment rule.

No set of interests – for example shareholder interests – should prevail over other
interests. However, out of keeping with the rest of the decision, the court did note that “[t]he
corporation and shareholders are entitled to maximize profit and share value, to be sure, but not
by treating individual stakeholders unfairly.”\textsuperscript{71} The court then rejected \textit{Revlon} and stated that the
“fundamental rule” is that the duty of directors is “a function of business judgment of what is in
the best interest of the corporation, in the particular situation it faces.”\textsuperscript{72}

When applying the above reasons to the case at hand the court stated “[i]n this case, the
Board considered the interest of the claimant stakeholders. Having done so, and having
considered its options in the difficult circumstances it faced, it made its decision, acting in what
it perceived to be in the best interest of the corporation.”\textsuperscript{73} Based on this analysis, the court
determined that the BCE board had fulfilled their fiduciary duty and not acted in an oppressive
manner.

The decisions in \textit{Peoples} and \textit{BCE} contrast starkly with the above mentioned line of cases
taking the position that in the change of control context, directors should focus exclusively on
increasing shareholder value. The upcoming section will critically examine the court’s decision.
Section III will then argue in favour of a fiduciary duty that requires directors to maximize
shareholder value in the change of control context.

\textsuperscript{70} \textit{BCE}, supra note 3 at 82.
\textsuperscript{71} \textit{Ibid} at 64.
\textsuperscript{72} \textit{Ibid} at 87.
\textsuperscript{73} \textit{Ibid} at 104.
II. Critique of the Current Fiduciary Duty in Canada

The Supreme Court’s formulation of director’s fiduciary duties in *BCE* appears to provide a new approach toward corporate governance in Canada. The BCE duty allows directors to consider all stakeholders when making decisions and encourages directors to act as a good corporate citizen. This section of the paper will raise a number of concerns and problems with the BCE duty. Part A will argue that the BCE duty is indeterminate. Part B will show how the BCE duty has left directors with no guidance for dealing with control transactions. Part C will examine the failure of the court in *BCE* to develop a theoretical model of the corporation to assist directors in discharging their fiduciary duty.

A. “The Best Interest of a Corporation”: An Indeterminate Duty

The fiduciary duty outlined in *BCE* fails to meet a very basic rule of law: “laws should be written with reasonable clarity to avoid unfair enforcement.” The BCE duty is vague, uncertain and indeterminate. The Supreme Court did not equate the term “best interest of the corporation” with any corporate constituent. Rather the corporation is treated as an entity in and of itself, which directors are required to act in the best interest of. The difficulty with such a standard is that the term “best interest of the corporation” does not provide any guidance to directors charged with managing a corporation. The phrase is unclear. The ambiguity lies in the fact that the doctrine of corporate legal personality does not translate into fiduciary law.

74 James Tory, “A Comment on *BCE Inc.*” (2009) 48 Can. Bus. L.J. 285 [Tory] (“However, the court, from its reasons in *BCE*, seems to have been unaware that there is even a debate, let alone that its rejections of shareholder primacy and its adoptions of a pure stakeholder approach to corporate fiduciary duties makes us an outlier in the Anglo-American corporate world” at 286 [Emphasis added]).

75 The remainder of the paper will refer to the duty as outlined in *Peoples* and *BCE* as the “BCE duty”.


77 *MacPherson*, supra note 19 at 402 (Arguing that rather than a fundamental shift to a stakeholder model, the court in *Peoples* simply “may have been trying to ‘tweak’ the law of directors’ duties, but they may have unintentionally gotten more than they bargained for.” at 396).

Established in the seminal judgment of *Solomon v Solomon & Co.*[^79], the doctrine of separate legal personality recognizes corporations as separate legal persons bearing the rights and capacities of a natural person. The purpose of this classification is to separate the assets and liabilities of the corporation from the individuals investing in it. From a policy perspective, the doctrine was introduced in hopes of making individuals more comfortable with investing in corporations knowing that they would not be personally liable for any debts or liabilities the corporation incurs.

Although classifying corporations as separate legal personalities serves the useful function of encouraging investment, the doctrine does not apply to fiduciary law. The essential problem of articulating a director’s duty in terms of “the best interest of the corporation” is that a corporation has no independent interest in any meaningful sense. The categorization of corporations as legal entities is a matter of convenience rather than reality – it is a legal fiction.[^80] It is the constituents that lay behind the corporation – employees, shareholders, creditors, suppliers, etc – whose interests are implicated through the corporation’s activities.

A corporation serves as a vehicle through which corporate constituents can pursue different ends. Each group will have independent purposes they hope to achieve through their interaction with the corporation. Shareholders seek to make returns on their investments, employees seek job security and wages, and creditors seek loan repayment. Unlike any of those constituents, the legal entity known as the corporation has no independent goals or welfare concerns.[^81]

[^79]: [1897] A.C. 22 (H.L.). The modern version of the doctrine is found in section 15 of the *CBCA* (“A corporation has the capacity and, subject to this Act, the rights, powers and privileges of a natural person”)


[^81]: *Iacobucci, supra* note 15 at 235 (“[t]o speak of the legal fiction that is the corporation as having a ‘best interests’ is nonsensical. A legal fiction does not have welfare gains or losses that we care about” at 235.)
Where a given course of action benefits all stakeholders, acting in the “best interest of the corporation” will prove to be a simple standard to satisfy. Directors can easily justify a decision as being in the “best interest of the corporation” if every corporate constituent profits from it. Difficulties arise where constituent interests conflict. One need not look further than the facts of *BCE* as an example of how various corporate constituents will not always agree on a given course of action. An effective fiduciary duty recognizes this inevitable conflict and provides a meaningful tool for resolving it. The indeterminate duty articulated in *BCE* fails to provide such a standard. *BCE*’s lack of guidance for dealing with conflicting stakeholders is demonstrated in the quote below:

> Directors may find themselves in a situation where it is impossible to please all stakeholders... There is no principle that one set of interest – for example shareholder interests – should prevail over another set of interests. Everything depends on the particular situation faced by the directors and whether, having regard to that situation, they exercised business judgment in a reasonable way.83

Reading the passage it is completely unclear how a director should respond to a conflict between stakeholders. Directors are given no guidance whatsoever. As Professor MacIntosh points out “[t]he Supreme Court appears to expect corporate directors, and judges *ex post facto*, to function as an enlightened breed of Philosopher Kings ardently and faithfully pursuing some elusive Aristotelian mean.”84

The indeterminacy of the BCE duty is problematic on a number of levels. First, boards will have little guidance when making decisions.85 Directors are forced to wait for lower court

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82 In *BCE* the shareholder stood to gain a 40% return while the debentureholders bonds were expected to decrease 20% in value.
83 *BCE, supra* note 3 at 83-84.
decisions to provide further guidance as to how to discharge their duty.\textsuperscript{86} Second, the increased discretion afforded to directors makes it increasingly difficult to challenge board decisions.\textsuperscript{87} The BCE duty provides no meaningful standard to which directors can be held accountable.\textsuperscript{88} Apart from blatantly self-interested or unreasonable board decisions, courts will be unlikely to interfere with director decision-making. Empowered with this insulation from challenge dishonest directors may try to entrench themselves or misbehave in other ways.\textsuperscript{89}

In addition, the BCE duty gives directors the opportunity to act in their own interest under the guise of protecting a corporate constituent, circumventing the very protection fiduciary duties were designed to achieve.\textsuperscript{90} Fiduciary duties have developed as a way to deter directors from exploiting corporate agency relationships. In this type of relationship, the principal (corporate constituents) authorizes the agent (director) to work under their control and on their behalf. In order to work effectively, the agent is given a significant amount of power and discretion. Fiduciary protection is necessary in order to ensure that the agent does not abuse the power. Fiduciary duties are meant to deter directors from acting in a self-interested manner. The BCE duty fails to provide such a deterrent. Directors are given the opportunity to act in their own interest as they can rationalize such action as benefiting any given stakeholder.

\textsuperscript{86} \textit{MacPherson, supra} note 19 at 402.
\textsuperscript{87} Wayne Gray, “A Solicitor’s Perspective on \textit{Peoples v. Wise}” (2005) 41 Can. Bus. L.J. 184 at 190 (“adopting of the indirect governance model will make it much harder in practice to challenge a board decision successfully. As long as the board can justify its decision based on its good faith consideration and balancing of a plurality of stakeholder interest, it becomes progressively more difficult for any one stakeholder to challenge that decision” at 190.)
\textsuperscript{88} \textit{Tory, supra} note 74 at 286.
\textsuperscript{89} \textit{Feasby, supra} note 19 at 86 and 119; \textit{MacIntosh, supra} note 84 at 255-256.
\textsuperscript{90} See generally \textit{Tory, supra} note 74.
Finally, the indeterminate BCE duty is of little value to any corporate stakeholder. As explained by Macey and Millar “fiduciary duties are not public goods.” As more groups enjoy fiduciary protection, the value associated with such protection decreases. If directors are permitted to consider multiple constituents when making a decision, there is no guaranteeing that a particular group will take priority over another. Thus, a fiduciary duty that fails to provide certainty to a party protected by it will be of little to no value. Any protection provided by a fiduciary duty that allows for consideration of multiple parties is moot because a corporate constituent will never know if their interests will be guarded in a given circumstance. There is little purpose in having a duty which provides no guarantee of protection for any party, be they shareholder or stakeholder.

B. Uncertainty: What Action Should a Board Take In the Change of Control Context

One of the most dissatisfying aspects of the BCE judgment is what it does not say. The Supreme Court failed to comment on the duty of directors in the change of control context. The court ignored a substantial body of jurisprudence that has taken the position that where a corporation is involved in a change of control transaction, focus should be placed on maximizing shareholder value.

The Supreme Court took the position that as a factual matter, BCE was “facing certain takeover” and that “BCE had been put in play, and the momentum of the market made a buyout inevitable.” Commentators have questioned these assertions. Alex Moore points out that BCE was put in play through a decision of the board. He notes that “[t]o conclude that a buyout was inevitable overlooks the question of whether the BCE board could legitimately have taken steps

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92 Ibid.
93 See Section 1, Part B.
94 BCE, supra note 3 at 106 and 112.
to frustrate any change of control transaction through defensive tactics." It is clear that BCE was not compelled by the market to take the actions that it did, rather that the actions were a voluntary decision of the board who were acting on the notion that they had an obligation to maximize shareholder value.96

By construing the facts in such a way as to make the sale of BCE inevitable the court sidestepped a very important issue: the role of the board when faced with a possible change of control transaction. The previous case law indicated that directors were permitted to undertake defensive tactics provided that the purpose was to maximize shareholder value. Under the BCE duty it remains unclear the extent that directors will be permitted to pursue defensive tactics and when those tactics are justified.97 This uncertainty is further magnified when one examines how securities law addresses the role of the board in control transactions.

Securities law plays an important role in governing change of control transactions. Under securities law, directors are required to focus on the interests of shareholders when in the midst of a control transaction. National Policy 62—202 governs defensive tactics in Canada.98 Although the policy is not strictly enforceable, it represents the position of securities regulators with respect to which actions a board will be permitted to take when faced with a change of control transaction.

The policy begins by emphasizing the important role that takeovers play in the economy.99 Takeovers are seen as providing a means of disciplining management and ensuring economic resources are put to their best use. The policy goes on to state that the primary

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95 Moore, supra note 85 at 276.
96 Fadel, supra note 18 at 203.
97 It is unclear whether the decision will permit defensive tactics be used to protect the interests of stakeholders.
99 Ibid at 1.1(1) (The Canadian securities regulatory authorities recognize that take-over bids play an important role in the economy by acting as a discipline on corporate management and as a means of reallocating economic resources to their best uses.)
objective of the take-over bid provisions in Canada is “the protection of the bona fide interests of the shareholders of the target company.” 100 Directors are permitted to “take action to maximize the return for shareholders.” 101 There is a preference for auctions in the policy, which also lists different defensive tactics that the regulators will find to be inappropriate. 102

The conflicting nature of securities law and corporate law places directors in a precarious position. On the one hand, securities law requires that they maximize shareholder value in the change of control context. On the other, corporate law permits directors to consider a wide range of interests above and beyond the shareholder. Directors may be faced with the lose/lose proposition of being disciplined by the regulators or breaching their fiduciary duty. From a policy perspective this inconsistency is surely not advisable.

C. Sitting on the Fence: Understanding the Modern Corporation

The indeterminate nature of the BCE duty may have been curtailed if the Supreme Court provided a coherent articulation of their conception of what a corporation entails and its broader social role. As Professor MacPherson notes “[e]ven if absolute certainty in advance is not possible, guiding principles become all the more important so that corporate directors can adjust their decision-making process.” 103 Although the court in BCE attempts to provide some guidance the analysis they provide proves yet again to be inconsistent and conflicting.

Corporate legal scholars have been debating the corporation’s role in society for over 80 years. This part of the paper focuses on the two most common and well known models of the corporation: stakeholder theory and shareholder primacy. 104 These two theories have very

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100 Take-Over Bid Rules, supra note 98 at 1.1(2) [emphasis added].
101 Ibid at 1.1(1).
102 Ibid at 1.1.
103 MacPherson, supra note 17 at 401.
104 More recently other theories have emerged including team production theory and director primacy. For a discussion on each see Margret Blair and Lynn Stout “A Team Production Theory of Corporate Law: (1999) 85 Vir.
different normative underpinnings and following many years of debate seem incapable of reconciliation. At a general level, stakeholder theory sees the corporation as a broad social actor with responsibilities greater than simply increasing profit. Shareholder primacy on the other hand, views the corporation as a nexus of voluntary contracts, the purpose of which is to increase value for shareholders.

Elements of both stakeholder theory and shareholder primacy are scattered throughout the BCE judgment. When outlining the law, the Supreme Court repeatedly utilized the rhetoric of stakeholder theory. However, the actual decision and the reasons given are more indicative of a shareholder primacy approach. Although outlining a theoretical model of the corporation may have provided some direction for board decision-making, the inconsistent use of polarized theories removes much credibility from the judgment. The following discussion will further outline stakeholder theory and shareholder primacy and how BCE relied on both of these theories in making their determination.

i. **Stakeholder Theory**

Much of the stakeholder rhetoric found in BCE was introduced during the courts’ analysis of the oppression remedy. The court took the position that directors’ fiduciary duty and the oppression remedy are closely intertwined: “cases dealing with claims of oppression have further clarified the content of the fiduciary duty of directors with respect to the range of interest that should be considered in determining what is in the best interests of the corporation, acting fairly and responsibly.”¹⁰⁵ When discussing the oppression remedy, the court alluded to many ideas associated with stakeholder theory.

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¹⁰⁵ BCE, supra note 3 at 39.
It should be noted that there is no definitive agreement on what stakeholder theory entails. Many of the early articulations of the theory have done so in the form of a negative critique towards shareholder primacy.\textsuperscript{106} Stakeholder theorists have begun to produce more positive arguments however the premise is still in its early stages.\textsuperscript{107} As such, the theory remains a relatively broad concept. It is clear from canvassing the extensive literature that stakeholder theory means different things to different scholars. Although there are disagreements between stakeholder theorists, they are all unified in their position that corporations should not be run solely in the interest of shareholders. The Supreme Court agreed stating “it is important to be clear that the directors owe their duty to the corporation, not to shareholders…”\textsuperscript{108}

Stakeholder theory provides an expansive view of the corporation. Early formulations of the theory can be found in the famous debate between Professor Berle and Professor Dodd in the \textit{Harvard Law Review}. In debating whom managers act as trustees for, Dodd argued that shareholder interests can be subjugated to other stakeholders and society at large.\textsuperscript{109} The articulation of stakeholder theory in its current form can be traced to R. Edward Freedman and his influential book, \textit{Strategic Management: A Stakeholder Approach}.\textsuperscript{110}

Most legal scholars see stakeholder theory as part of a broader communitarian theory of corporations. Communitarians view the corporation as a complex interaction of relationships where obligations arise independent of contract. As Million notes, communitarians focus on the reciprocal relationships that corporations foster: “[a]cknowledging our interdependence, we must

\textsuperscript{108} \textit{BCE, supra} note 3 at 66 [Emphasis added].
\textsuperscript{109} See \textit{Dodd, supra} note 1.
\textsuperscript{110} Keay, \textit{supra} note 106 at 6.
recognize our responsibility for the quality of the lives of all community members.”

Communitarians agree that liberty is an important ideal in society, but argue that liberty also entails positive obligations. Markets need to operate within a social framework that cannot be entirely structured out of private agreement.

While discussing the oppression remedy the Supreme Court placed an emphasis on the importance of fair treatment. The court noted “the ‘fair treatment’ component of the duty...is fundamental to the reasonable expectation of shareholders claiming an oppression remedy.”

Similarly, stakeholder theory is founded on values such as fairness and trust. Some scholars have argued that stakeholder theory has its origins in Kantian theory which asserts that individuals should be treated as ends and not means to ends.

Stakeholder theory starts from the communitarian proposition that the purpose of the corporation is to promote overall social good. The theory rejects the idea that a corporation’s sole purpose is making money. Corporations are recognized as important actors in society and not just an investment vehicle for owners of financial capital. This broader mandate was

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111 Millon, supra note 107 at 1382-1383
112 Ibid at 1383
113 BCE, supra note 3 at 36.
114 See Robert Phillips, “Stakeholder theory and a Principle of Fairness” (1997) 7 Bus. Ethics Quar. 51 (“Whenever persons or groups of persons voluntarily accept the benefits of a mutually beneficial scheme of co-operation requiring sacrifice or contribution on the parts of the participants and there exists the possibility of free-riding, obligations of fairness are created among the participants in the co-operative scheme in proportion to the benefits accepted” at 57.)
115 Janice Dean, Directing Public Companies (London: Cavendish, 2001) (“the decision to trust, in business as elsewhere centres on interpersonal expectations, the willingness to accept temporary vulnerability and optimism about one’s partner’s behaviour” at 107.)
recognized in BCE as the court repeatedly referenced the idea that corporations should strive to be a “good corporate citizen”.\textsuperscript{119}

One reason why stakeholder theory favours a broad public mandate for corporations is due to corporations’ external influence. Stakeholder theory conceptualizes the corporation as large and influential institutions whose conduct can have substantial impact on society.\textsuperscript{120} Of the largest 150 economic entities in the world 95 are corporations.\textsuperscript{121} Given the powerful position that corporations hold in today’s world, stakeholder theorists argue that corporations have a broad obligation to society. If corporations are permitted to focus solely on profit maximization a potential opportunity for societal betterment is eluded.

In addition to the external influence of corporations, stakeholder theory focuses on the wide range of interests which make up the corporation. The Supreme Court recognized this in \textit{BCE} stating “a corporation is an entity that encompasses and affects various individuals and groups.”\textsuperscript{122} Stakeholder theorists argue that each corporate constituent is integral to the success of the corporation.\textsuperscript{123} Each of these parties (not just shareholders) makes firm-specific investments. It would be unfair for directors to ignore the interests of the parties that contribute to the success of the corporation and focus only on shareholders. The notion of fair treatment of stakeholders was introduced in the Supreme Court discussion of the reasonable expectation doctrine under the oppression remedy:

\begin{itemize}
\item \textsuperscript{119} \textit{BCE supra}, note 3 (“[d]irectors acting in the best interest of the corporation, may be obliged to consider the impact of their decisions on corporate stakeholders” at 66).
\item \textsuperscript{120} Jeffery Bone, “Corporate Social Responsibility in the Wake of The Supreme Court Decision of \textit{BCE Inc. and Bell Canada}” (2009) 27 Windsor Rev. Legal & Soc. Issues 6 at 8.
\item \textsuperscript{121} Rhett A. Butler, “Corporations among largest global economic entities, rank above many countries (18 July 2005) <http://news.mongabay.com/2005/0718-worlds_largest.html>.
\item \textsuperscript{122} \textit{BCE, supra} note 3 at 64.
\end{itemize}
The corporation and shareholders are entitled to maximize profit and share value, to be sure, but not by treating individual stakeholders unfairly. Fair treatment – the central theme running through the oppression jurisprudence – is most fundamentally what stakeholders are entitled to reasonable expect.\textsuperscript{124} As each stakeholder contributes to the corporation, they should be treated fairly and benefit from their contributions.\textsuperscript{125}

The Supreme Court stopped short of some arguments made by stakeholder theorists. For stakeholder theorists, corporate law should be structured in a way that facilitates the goal of societal betterment.\textsuperscript{126} Stakeholder theory rejects economics and efficiency as ultimate values and contemplates a broader social mandate for corporate law.\textsuperscript{127} Although in BCE the court did allude to the notion of a “good corporate citizen” it did not go as far as to say that corporations should be run in order to benefit all of society.\textsuperscript{128}

It is clear that the Supreme Court utilized many ideas associated with stakeholder theory in BCE. Indeed commentators have argued that BCE has introduced a stakeholder model of corporate governance in Canada.\textsuperscript{129} However, the BCE courts analysis provides an interesting irregularity. Although the stated law closely resembled a stakeholder approach, the analysis and ultimate decision of the court falls in line with contemporary thinking on shareholder primacy. In particular, the court relied heavily on ideas associated with contractarian theory. At present, contractarian theory is considered by many scholars to provide the strongest underpinning for

\begin{itemize}
    \item \textsuperscript{124} BCE, supra note 3 at 64.
    \item \textsuperscript{125} Keay, supra note 106 at 6.
    \item \textsuperscript{126} Ronald Daniels, “Stakeholders and Takeovers: Can Contractarianism be Compassionate?” (1993) 43 U.T.L.J. 315 at 329. (Daniels argues that stakeholder injury is more preferable viewed through the lens of contractual failure. As such it is appropriate for the state to intervene to expand the range of protection for stakeholders.)
    \item \textsuperscript{127} Sheehy, supra note 117 at 201.
    \item \textsuperscript{128} BCE, supra note 3 at 66.
    \item \textsuperscript{129} See Tory, supra note 74.
\end{itemize}
shareholder primacy. The use of both shareholder primacy and stakeholder theory removes credibility from the decision and clouds the meaning of the decision. The following subpart explains shareholder primacy in more detail.

ii. Shareholder Primacy

The shareholder primacy approach towards the role of corporations in society differs significantly from stakeholder theory. Shareholder primacy advocates a simple unilateral purpose for corporations – to increase the value of shareholders residual claims. As such, directors should focus exclusively on shareholders wealth maximization when making decisions. Until the decisions in Peoples and BCE many commentators considered shareholder primacy to be the dominant approach toward directors’ fiduciary duties in Canada. However, Binnie J. explicitly rejected shareholder primacy in Peoples stating, “it is clear that the phrase the ‘best interest of the corporation’ should be read not simply as the ‘best interest of the shareholders’.”

In BCE the Supreme Court followed Peoples and rejected shareholder primacy. However, the court relied heavily on contractarian ideas associated with shareholder primacy. Contractarian theory has been the dominant approach to corporate law for decades. Unlike previous conceptualizations which equated corporate law to a branch of the law of trusts or a legal fiction created by statute, contractarian theory viewed the corporation as a nexus of

130 Prior to contractarian theory, shareholder primacy was usually justified on the basis that shareholders owned the corporation. Proponents of the argument were of the view that as owners, shareholders were the most deserving of the protection afforded by an exclusive fiduciary duty. This position was advocated by scholars such as Adolf Berle and Milton Freedman. As time passed scholars begin to critique the shareholder-as-owner analogy. Critics argued that shareholders did not own the corporation in any real sense, rather simply owed their shares. Shareholders had no rights to the corporation’s assets or earnings and no control over operation decisions. See Lynn Stout, “Bad and Not-So-Bad Argument for Shareholder Primacy” (2002) 75 S. Cal. L. Rev. 1189 at 1190-1192.
131 See note 19.
132 Peoples, supra note 2 at 42.
133 Berle, supra note 1 at 1074.
contracts. Early articulations of the theory can be traced back to the work of Ronald Coase who suggested that the corporation served as “a vehicle that internalized the multiple relationships existing between the various constituencies.” This approach was later adapted by Jensen and Meckling. To these scholars, the corporation was a legal fiction which served as a nexus of contracting relationships that took place between the corporation and the various owners of labour, capital inputs and outputs, and material. In order to minimize agency problems that result from the separation of ownership and control, it was thought that shareholders should be given exclusive right to control the firm.

Frank Easterbrook and Daniel Fischel added to the nexus of contract approach with their seminal work *The Economic Structure of Corporate Law*. Like those before them, Easterbrook and Fischel focused on the role of voluntary ordering with regard to corporate governance:

The corporation is a complex set of explicit and implicit contracts, and corporate law enables the participants to select the optimal arrangement for the many different sets of risks and opportunities that are available in large economy. No one set of terms will be best for all; hence the ‘enabling’ structure of corporate law.

Easterbrook and Fischel added further to contractarian theory with their analysis of shareholders’ residual claimant status. A residual claim is a claim to a share of a corporation’s earnings, after all debt obligations have been satisfied. For each share, a shareholder is entitled to the

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138 Easterbrook, supra note 80 at 1418.
proportional value of the corporation after all other debts have been paid off. Thus shareholders “get only what is left over - but they get all that is left over.”

Residual claimants can be contrasted with fixed claimants. A fixed claim allows the holder of the claim to be paid out first; however, they are only entitled to be paid the specific value associated with their claim. A classic example of a fixed claim is a bond. A bondholder is entitled to be paid back a fixed amount as per the terms of the bond agreement. The success of the corporation will have no impact on the bondholders claim. No matter how the corporation performs, fixed claims will be entitled to the same amount and they will be entitled to that amount before any residual claim is paid out.

According to Easterbrook and Fischel, shareholders’ status as residual claimants justifies their interests being placed above all other stakeholders.\textsuperscript{139} Shareholders have an incentive to ensure that the corporation will be run in such a way as to maximize residual earnings.\textsuperscript{141} The more profit that a corporation earns over and above their fixed claims, the greater the benefit for all stakeholders.

Contractarians argue that the ability of stakeholders to contract with the corporation places them in advantageous position \textit{vis-à-vis} shareholders. Stakeholders have the ability to negotiate protections from themselves; employees enter into employment contracts and have the ability to negotiate the terms of those contracts; creditors enter into loan agreements that specify interest rates and allocate certain risks, etc. On the other hand, shareholders do not have any ability to set any terms in return for their investment of capital. For contractarians the inability of

\footnotesize{\begin{itemize}
\item \textsuperscript{139} Easterbrook, supra note 80 at 1425.
\item \textsuperscript{140} Easterbrook, supra note 80 at 1425.
\item \textsuperscript{141} Macey, supra note 134 at 1275 (The argument was stated succinctly by Macey: “shareholders retain plenary authority to guide the date of the corporate enterprise because they have the greatest stake in the outcome of the corporate decision-making.”)
\end{itemize}}
shareholders to protect themselves through contract provides a justification for exclusive fiduciary protection.

The Supreme Court relied on many of the aforementioned contractarian ideas in BCE. In particular, the court emphasized the fact that the debentureholders had the ability to protect themselves through contract but failed to do so:

Trust indentures can include change of control and credit rating covenants where those protections have been negotiated. Protection of that type would have assured debentureholders a right to vote, potentially through the trustee, on the leveraged buyout, as the trial judge pointed out. The failure to negotiate protection was significant...  

The Supreme Court found it reasonable for directors to accept an offer that substantially benefitted shareholders. The fact that the offer had deleterious consequence for debentureholders was unfortunate but no legal remedy was necessary as they had the ability to protect themselves but failed to do so. Had the debentures included a fairly common change of control clause they would have been compensated for the decline in value resulting from the change in control.

In addition, the ultimate result in BCE is in keeping with shareholder primacy. Although the court rejects Relvon and the notion that directors have an obligation to maximize shareholder value, the court found no fault in the BCE board which proceeded on the basis that their obligation required them to maximize shareholder value.  

Colin Feasby has commented on this interesting inconsistency, “[t]he Supreme Court’s reasons in BCE appear to herald a softer and gentler corporate law... and simultaneously deploy contractarian analysis to arrive at a pro-shareholder result. As a result, BCE provides no clear standard or guidance to boards of directors confronting similar circumstances in the future.”

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142 BCE, supra note 3 at 108 [Emphasis added].
143 Feasby, supra note 19 at 119.
144 Ibid.
III. Shareholder Primacy: The Superior Approach

By rejecting shareholder primacy in Peoples and BCE the Supreme Court abandoned a fundamental tenant of corporate law. Although courts have always played an important role in guiding the legal system, the oddity of Peoples and BCE is that the court failed to provide any reasons as to why the rule should not operate in Canada.\textsuperscript{145} Instead, they simply stated that directors have long been able to consider the interests of other stakeholders. Although debate continues as to whether or not that was the case, it seems clear that the court did not do justice to shareholder primacy by rejecting it outright without any accompanying reasons.\textsuperscript{146}

This section of the paper will argue that the largest potential problem with the BCE duty involves its approach to change of control transactions. Control transactions represent circumstances where shareholders are most vulnerable to abuse by self-interested directors. In order to address this concern, this paper proposes a fiduciary duty that requires directors to focus exclusively on maximizing shareholder value in the change of control context.

This section will be divided into four parts. Part I will begin by examining why the change of control context necessitates that shareholders be protected by an exclusive fiduciary duty. The remaining parts will propose and critically examine a variety of arguments in favour of shareholder wealth maximization in the change of control context. Part B will argue that the duty provides a coherent and enforceable rule. Part C will argue that stakeholders are sufficiently protected through means outside of fiduciary protection. Part D will argue that shareholders require fiduciary protection as they bear the greatest risk of all corporate constituents.

\textsuperscript{145} Peoples, supra note 2 (“The courts have long recognized that various other factors may be relevant in determining what director should consider when soundly managing with a view to the best interest of the corporation” at 42.)

\textsuperscript{146} See, Lee, supra note 19 at 213.
A. Why an Exclusive Duty is needed in the Takeover Bid Context?

What is it about the change of control context that makes it necessary for directors to focus exclusively on maximizing shareholder value? To be sure, most arguments made in favour of a duty to maximize shareholder value in the change of control context would apply with equal force to the day-to-day operations of a corporation. Speaking to the question Professor Iacobucci has argued that “there is no reason to conclude that shareholders should suddenly matter, and that other stakeholders should suddenly recede in importance, when a takeover bid arises.”\footnote{Iacobucci, supra note 15 at 250.}

This paper seeks to provide an argument as to why the change of control context mandates different fiduciary duties. From a practical perspective, exclusive fiduciary duties are not necessary outside the change of control context because directors’ interests are sufficiently aligned with shareholders through other means. Where a corporation is operating as a going concern, shareholders are protected through legal and market-based incentives that fuse the interests of directors with that of shareholders. The fact that BCE allows directors to consider the interests of non-shareholders will do little to curtail such incentives. If the BCE duty simply permits directors (it does not require) to consider the interests of stakeholders, it is unlikely that it will have a significant impact on director decision-making outside the change of control context.

There are a variety of market-based and legal incentives which persuade directors faced with the option of choosing between stakeholders and shareholders to opt in favour of the latter. First, shareholders’ power to elect directors provides an incentive for directors to consider the interest of shareholder above that of non-shareholders.\footnote{See CBCA, supra note 4 at section 137(4).} Shareholders also have the power to
requisition a meeting where the entire board may be removed.\textsuperscript{149} Although traditionally the right to elect and remove directors has not provided a significant obstacle on management behaviour the current position is not as clear.\textsuperscript{150} The potential for activism by institutional investors provides a strong incentive for directors to focus on the interests of shareholders. As Millon points out “in cases in which management must choose between promoting shareholder welfare at a cost to non-shareholders or protecting non-shareholders at the shareholders’ expense, the existence of shareholder voting rights encourages management to prefer the former option.”\textsuperscript{151}

Professor Bainbridge has criticized the idea that shareholder voting rights impact significantly on director decision-making. He notes that “in practice…even the election of directors, absent a proxy context, is predetermined by the existing board nominating the next board.”\textsuperscript{152} In addition, he points to evidence that activism among institutional shareholders has had little impact on director decision-making.\textsuperscript{153}

Others such as Professors Hansmann and Kraakman have argued that shareholders have a more powerful voice than ever before. Speaking of the diffusion of share ownership they point out that institutional investors “not only give effective voice to shareholder interests, but promote the voice of dispersed public shareholders.”\textsuperscript{154} Although it is unclear the extent that the ability to elect and remove directors plays in board decision-making it may nevertheless sit in the back of their minds when making determinations.

\textsuperscript{149} CBCA, supra note 4 at section 143.
\textsuperscript{151} Millon Redefine, supra note 118 at 261.
\textsuperscript{152} Bainbridge, supra note 104 at 569.
\textsuperscript{153} Ibid (“However, there is relatively little evidence that institutional investor activism has mattered. Due to a resurgence of direct individual investment in the stock market, motivated at least in part by the day trading phenomenon and the technology stock bubble, the trend toward institutional domination has staggered” at 571.)
Executive compensation schemes provide another incentive for directors to favour the interests of shareholders.\(^{155}\) Public companies are increasingly compensating directors with shares and requiring them to hold a significant number of their securities.\(^{156}\) Indeed, the Canada Coalition for Good Governance lists share ownership as one of its guiding principles of executive compensation: “The compensation committee should require executives to build and maintain a significant equity investment in the company. Consideration should be given to holding periods beyond retirement.”\(^{157}\) The underlying rationale for this type of compensation is that where directors’ have a financial stake in the corporation they will perform their role at a higher level. A byproduct of compensating directors with shares is that it gives them an incentive to favour the interests of shareholders.\(^{158}\) As directors hold a large amount of equity in corporations they work for, they have a pecuniary incentive to make decisions that favour the interests of shareholders.

There are a variety of market-based incentives that align the interests of directors and shareholders. These incentives are the result of pressure placed on directors to compete effectively in their market. Although they may not guarantee that management always focuses exclusively on shareholder interests “they still generate systematic pressure that lead management away from costly polices beneficial to non-shareholders.”\(^{159}\)

Product or market competition between firms is one market-incentive that aligns the interests of shareholders and directors. Directors are under pressure to reduce costs in order to

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\(^{155}\) Millon Redefine, supra note 118 at 261.


\(^{158}\) Chowdhury, supra note 156.

\(^{159}\) Millon Redefine, supra note 118 at 262.
remain competitive with other firms in their industry. Millon gives the example of a firm deciding whether or not to shut down an old factory to reduce costs.\footnote{\textit{Ibid.}} Failure to do so may put the firm at a disadvantage \textit{vis-à-vis} their competitors. Given these concerns management is encouraged to pursue efficiency over non-shareholder concerns.\footnote{\textit{Ibid.}} Millon also argues that focus on non-shareholder interests may put firms at a disadvantage when attempting to secure debt financing or additional equity financing.\footnote{\textit{Ibid} at 262-263.} Given the variety of incentives directors have to consider the interests of shareholders over stakeholders, it is not surprising that even strong supporters of stakeholder based models of corporate governance have conceded that “if there is no legal requirement that management protect non-shareholders, it is unlikely they will do so.”\footnote{\textit{Millon Redefine}, supra note 118 at 264.}

The change of control context presents a circumstance where directors’ self-interest has a greater potential to conflict with shareholder interests. When a corporation is changing ownership there is strong potential that directors may lose their jobs.\footnote{\textit{Unocal}, supra note 23.} Many takeovers are the result of mismanagement and provide a tool for reallocating economic resources to their best use. Given the negative consequences that takeover bids may have on directors, concern over their livelihood may take precedent over and above the legal and market incentives which tie their interests with shareholders.

In order to avoid potential self-interested actions, it is necessary that directors involved in change of control transactions have an obligation to look exclusively towards the interests of shareholders when making decisions. Market incentives no longer function to align the interests of directors with shareholders as it is unlikely they will be working with the company in the near future. If directors can justify their decision-making on the basis that it protects the welfare of a
given stakeholder, they are effectively given a *carte blanche* to act in their own interest. As such, legal constraints are necessary in order to achieve adequate shareholder protection.

In addition, a standard that requires directors to maximize shareholder value in the change of control context is more efficient than the BCE duty. All control transaction ultimately need to be approved by shareholders. If directors recommend a transaction that benefits stakeholders at the expense of shareholders, it is very unlikely that shareholders will approve it. Requiring directors to consider the interest of those that make the ultimate determination is a logical policy choice.

Whether an exclusive fiduciary duty provides the best means of protecting shareholders is a matter of debate. It could be argued that the use of a special committee composed of independent directors, in addition to fairness opinions by independent advisors, are sufficient methods of ensuring that self-interested directors do not taint decisions. This paper takes the position that although there are other mechanisms that can be used to protect shareholders, fiduciary duties are best suited to do so.¹⁶⁵ A special committee will be better at fulfilling their role and more easily monitored if they are guided by a clear mandate. The following Parts will examine arguments in favour of shareholder primacy and why it is the preferable approach to dealing with control transactions.

**B. Shareholder Primacy Provides a Coherent and Enforceable Duty**

In contrast to the uncertain and indeterminate BCE duty, one of the strongest arguments in favour of shareholder primacy is that it provides a coherent and enforceable rule that is easy for directors to follow. Directors have a clear measuring stick to base their decisions on. In addition, shareholder wealth maximization provides a strong enforcement mechanism for

¹⁶⁵ See Section III Part D.
misbehaving directors. Shareholder primacy “draws the clearest line between decisions that breach the fiduciary duty [and those that do not].”166 Directors can be monitored relatively easily when their performance is measured through inspection of share price. Former Dean of Harvard University Law School Robert C. Clark put it this way:

A single objective goal like profit maximization is more easily monitored than a multiple, vaguely defined goal like the fair and reasonable accommodation of all affected interest…. Assuming shareholders have some control mechanisms, better monitoring means that corporate managers will be kept more accountable. They are more likely to do what they are supposed to do and do it efficiently.167

Shareholder primacy provides a simplified standard for courts to determine whether a director has breached his or her fiduciary duty. Easy monitoring will improve corporate efficiencies and reduce agency costs.168 During control transactions directors would have to show that a transaction is in the best interest of shareholders. This determination would primarily focus on share price; however, other considerations such as deal certainty, fairness opinions and formal valuations would factor in as well.

Although shareholder primacy provides a coherent framework for directorial accountability it is not without its flaws. Determining what is in the “best interest of shareholders” may prove to be difficult, if not impossible.169 What one shareholder may perceive to be in their best interest may contrast starkly with the views of another. Shareholders may have different investment horizons.170 While long-term investors may focus on the lasting viability of the corporation, other shareholders, such as arbitrageurs, may focus exclusively on short-term

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170 Ibid.
returns. Further, the makeup of a shareholders’ portfolio may impact their perceived best interest. The interests of diversified shareholders will be very different from the interests of undiversified shareholders.\textsuperscript{171}

There is also a substantial variety of shares available on the market. The most common difference arises between the interests of common stock and preferred stock. Preferred stock carries with it a preference over common stock in the distribution of assets upon liquidation and the payment of dividends.\textsuperscript{172} As such, preferred stocks bear a closer resemblance to fixed claims than residual claims. Directors forced to choose between preferred shareholders and common shareholders will find the “best interest of the shareholders” standard to be of little assistance.

Although shareholder interests are by no means monolithic, of all corporate constituents they are the most likely to agree on a given issue. There is no other stakeholder group as homogenous as shareholders.\textsuperscript{173} Employee interests may conflict on relative wages and on many of the “firm’s investment decisions, such as which plants to keep open, which processes to automate, or where to improve safety.”\textsuperscript{174} Similarly, secured and unsecured creditors’ interest may be substantially divided, “secured creditors will generally be less hostile to increases in firm risk than will unsecureds, since they are better protected in the event of insolvency.”\textsuperscript{175} Shareholders, on the other hand, are likely to be unified in their desire to increase the residual value of the corporation.

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  \item[171] Wallman, supra note 169 at 174.
  \item[172] Van Der Wiede, supra note 168 at 38.
  \item[173] Roberta Romano, Metapolitics and Corporate Law Reform (1984) 36 Stan. LF 923 at 952-3. (“Because in perfect capital markets a shareholder can adjust his preferences for consumption over time by borrowing or lending against his wealth (the value of his shares), which increases directly as the firm’s value increases, managers need only follow the decision rule of choosing the production plan that maximizes the firm’s value and each owner is made as well-off as possible. Shareholder can therefore give their manager-agents a decision rule that does not require the discovery and reconciliation of the personal time preferences (consumption decision) of multiple principals.”)
  \item[175] MacIntosh Fiduciary Duty, supra note 166 at 455.
\end{itemize}
\end{footnotesize}
In any event, the fact that shareholder interests diverge does not provide a strong argument for having directors consider additional divergent interests. As pointed out by James Hanks “[i]t is a non sequitur to argue that because it is difficult for directors to determine the best interests of a large, diverse group of stockholders, the directors should therefore be authorized to determine the best interest of an even larger, more diverse group of nonshareholders.”176

Focusing specifically on control transactions, concerns regarding shareholder divergence may be overstated. Although day-to-day operational decisions may generate controversy among different shareholders, a change of control transaction will likely unify shareholders. When it becomes clear that the corporation is to be sold, rational shareholders will seek to maximize the value of their investment. Although there may be differences as to what qualifies as an acceptable price, shareholders will be united in wanting to obtain the best value available for their investment.

C. Protecting Stakeholders in the Change of Control Context

Critics of shareholder primacy argue that change of control transactions allow shareholders to transfer stakeholder wealth to themselves. Speaking of the American hostile takeover market in the 1980s Karmel notes that “bondholders have complained that the size of a takeover premium reflected a portion of their capital.”177 Additionally, employees complain they have been deprived of their human capital contributions to a corporation when layoffs followed a takeover.178

Stakeholder theorists have argued that the gains experienced by shareholders during hostile takeovers come at the expense of stakeholders. In economic terms, it was argued that

shareholder gains were redistributive from labour or bondholders. As time passed scholars began to question the empirical validity of the redistribution argument. Studies have now shown in a compelling fashion that shareholder gains in change of control transactions do not come at the expense of stakeholders.\footnote{For a literature review see Roberta Romano, “A Guide to Takeovers: Theory, Evidence, and Regulation” (1992) 9 Yale J. on Reg. 119, 136-142.} Daniels explains the situation in this way:

> In most case, both the shareholders and the stakeholders lost the investment made in the stakeholders’ firm specific capital. If a corporation is forced to displace a stakeholder whose firm-specific capital has depreciated more quickly than anticipated, this is a loss both for the corporation (that is, shareholders) and the stakeholder. The reason why shareholders gain – despite the loss related to obsolete stakeholder firm-specific capital – is that there are other related gains (synergies, improved management, monopoly profits, tax benefits) from a takeover that are split between acquiring and target shareholders.\footnote{Daniels, supra note 126 at 334.}

Thus, the gains created for shareholders during hostile takeovers exceed the combined losses felt by stakeholders.

It is also clear that although shareholder gains are not redistributive, stakeholder interests may still suffer as a result of control transactions. Stakeholders form an integral part of any successful corporation and have valid interests worth protecting. Where there is a control transaction stakeholders may suffer considerable loss. For example, employees have sometimes lost their jobs and endured pension benefit and wage reductions. Creditors may suffer as a result of increased debt load which reduces the value of their products. Local communities may lose tax revenue.

Stakeholders argue that protections need to be put in place to mitigate any damage that results from control transactions. There is a plethora of thought regarding how to ensure that stakeholder interests are not disregarded. Some commentators argue for larger roles for
stakeholders in board decision making.\textsuperscript{181} Others feel that fiduciary protection provides the best solution.\textsuperscript{182} This paper argues that stakeholder protection is most effectively dealt with outside the realm of fiduciary protection through the mechanisms of contract, legislation and the political process. Although individually these types of protection suffer from different short-fallings, collectively they provide an effective regime for ensuring that the interests of stakeholders are upheld. At the same time, by using these protective mechanisms rather than fiduciary duties, concerns regarding diluted fiduciary duties and the accompanying potential for management opportunism are avoided.\textsuperscript{183} The following sub-parts will examine the protection mechanisms of contracting, legislation and the political process.

i. Contracting

Stakeholders first line of protection is afforded through their ability to contract with the corporation. Stakeholders have the “technological” ability to protect their interest through agreement.\textsuperscript{184} Stakeholders can shield themselves against almost every type of director misbehavior by retaining negative control over the corporation’s operations. Bondholders, workers and even local communities have the ability to protect their interests by contracting for the right to veto future proposed action by directors.\textsuperscript{185}

Speaking specifically to the change of control context, stakeholders have a wide range of contractual mechanisms they can utilize in order to protect their interests. Workers and

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\textsuperscript{181} This type of corporate governance model is more common in Europe and Japan. See generally Marc Lowenstein, Stakeholder Protection in Germany and Japan” (2001) 76 Tul. L. Rev. 1673.
\textsuperscript{182} Ronald Green, “Shareholders as Stakeholders: Changing Metaphors of Corporate Governance” (1993) 50 Wash. & Lee. L. Rev. 1409 (Green argues that “fiduciary of various sorts commonly find themselves pulled between competing duties... why cannot corporate directors and senior managers be asked to do the same?” at 1418.) [Green].
\textsuperscript{183} See Section 1 Part A.
\textsuperscript{184} Jonathan Macey, “An Economic Analysis of the Various Rationales for Making Shares the Exclusive Beneficiaries of Corporate Fiduciary Duties” (1991) 21 Stetson L. Rev. 23 at 40.
\textsuperscript{185} Macey and Miller, supra note 91 at 417.
\end{flushright}
employees can (and do) negotiate golden parachutes.\textsuperscript{186} Creditors such as bondholders can utilize poison puts.\textsuperscript{187} The opportunity for contracts to protect stakeholders places them in a unique and favourable position. Although fiduciary duties provide broad and sweeping protection, they do so in the form of gap filling devices. Macey makes the point that “fiduciary duties only operate in the shadow of the express contractual arrangements that nonshareholders constituencies have with the firm.”\textsuperscript{188} Thus in the change of control context, fiduciary duties to maximize shareholder value do not void any contractual protections that stakeholders have in place. Shareholders are entitled to maximize shareholder value, but only after all contractual obligations are honoured.

Although contracting provides a powerful tool for stakeholder self-protection there are a number of practical impediments which reduce its effectiveness in certain situations.\textsuperscript{189} Firstly, it is difficult for parties to plan for future contingency when drafting a contract. Unforeseen circumstances may arise. Attempting to plan for every eventuality through contract is impossible. Further, asymmetric information between contracting parties reduces the potential for meaningful protection of stakeholders. Daniels points out serious infirmities that plague the stakeholder-corporation bargaining environment:

| Information regarding the likelihood and magnitude of certain events may be unavailable or mistaken. Endemic agency problems may hobble the capacity of various stakeholder groups, for example, organized labour, to negotiate effectively, with management… [Further] certain legal infirmities may impair the capacity of stakeholders to enforce corporate undertakings.\textsuperscript{190} |

It is clear that in many circumstances the reality of contractual formation impedes stakeholders from meaningful self-protection. In certain circumstances judges may be relied upon to provide

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\textsuperscript{186} Van Der Weide, \textit{supra} note 168 at 42.
\textsuperscript{187} \textit{Ibid} at 419.
\textsuperscript{188} Macey, \textit{supra} note 134 at 1275.
\textsuperscript{190} Daniels, \textit{supra} note 126 at 328.
“gap-filling functions”\textsuperscript{191}, however judicial ex-post protection brings with it additional costs and elements of uncertainty.\textsuperscript{192}

In addition, disparity of bargaining position between stakeholders and the corporation may prevent contractual protection for stakeholders from being negotiated. As noted by Zumbansen and Archer “not all contracting parties engage in the bargaining process with the same pedigree of expertise and freedom from coercion.”\textsuperscript{193} Although some stakeholders have the ability to contract with the corporation, those in weak bargaining positions are unable to do so in any meaningful sense. Many times those stakeholders are faced with a take it or leave it proposition.\textsuperscript{194} Even those stakeholders who have the opportunity to negotiate with the corporation may be prevented from achieving meaningful protection as they may not foresee preserved risks or protect themselves effectively.

ii. Legislation

Given contracting is not always effective at protecting stakeholders, further protections are necessary. The use of legislation provides another tool for ensuring that stakeholders interests are not disregarded. As noted by Daniels “a preferable way of thinking about stakeholder injury is through the prism of contractual failure… [as such] state intervention expands the range and effectiveness of instruments that can be used to protect stakeholders and improve societal welfare.”\textsuperscript{195} In situations where contracting is unable to provide an effective protection

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\item \textsuperscript{191} Macey and Miller, supra note 91 at 417-418. (“Thus, the gap-filling functions provided by modern judges in interpreting contracts provides workers with the same sort of protection that fiduciary duties provide for shareholders” at 417.)
\item \textsuperscript{192} Morey McDaniel, “Stockholders and Stakeholders” (1991) 21 Stetson L. Rev. 121 at 155.
\item \textsuperscript{193} Peer Zumbansen and Simon Archer, “The BCE Decision: Reflections on the Firm as a Contractual Organization” (2009) 4 CLPE Research Paper Series 1 at 14 [Zumbansen].
\item \textsuperscript{194} Green, supra note 182 at 1418.
\item \textsuperscript{195} Daniels, supra note 126 at 317.
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mechanism legislation has been used. There already exists an extensive body of law that ensures that stakeholders are not disregarded.\textsuperscript{196}

iii. **Lobbying and the Political Process**

Although legislation provides a good deal of protection for stakeholders, new circumstances may arise where stakeholders are put at additional risk. In those situations, the ability of stakeholders to engage in the political process provides a further mechanism of protection.\textsuperscript{197} Many stakeholder groups are part of larger concerted political lobbying organizations.\textsuperscript{198} These groups are able to exercise considerable political pressure on governments to enact legislation that protects their interests. As noted by Professor Fisch “[o]ther corporate stakeholders may have particular advantages in political participation relative to shareholders. Their interest may be aligned along a range of political issues. They may be repeat players. They may have greater stakes.”\textsuperscript{199} In contrast, shareholders are for the most part scattered individuals with little or no political voice.

The ability of stakeholder groups to lobby government is evident through the wide array of legislative mechanisms currently in place to protect stakeholders. The 1960s and 1970s introduced an assortment of social welfare legislation. These laws provided protection for a variety of stakeholders including employees and the environment. As noted by Professor Winkler:

> Unlike corporate law reforms, however, social welfare legislation of this period sought to cabin managerial discretion over important aspects of hiring, operations and production. Although this vast array of social welfare legislation is not corporate law per se, it

\textsuperscript{196} MacIntosh *Fiduciary Duty, supra* note 166 at 453.
\textsuperscript{197} Stephen Bainbridge, “In Defense of the Shareholder Wealth Maximization Norm: A Response to Professor Green” (1993) 50 Wash. & Lee L. Rev. 1423 at 1443 [Bainbridge I].
\textsuperscript{198} Ibid at 1444.
remains a vibrant constraint on managerial decision making, adopted in the name of non-shareholder constituencies of corporations. \(^ \text{200} \)

Stakeholders’ capacity to interact with government to create specifically tailored legislative responses to their concerns gives them an advantage versus shareholders who have less leverage and ability to do so.

Government also provides a better forum to make trade-offs between the various interests at stake. \(^ \text{201} \) Directors are ill-suited at making determinations of public welfare as they lack the necessary information and resources to do so effectively. \(^ \text{202} \) Politicians and legislatures are much better suited for these types of decisions. They are able to debate and research a wide array of solutions and decide on the best alternative. They are also politically accountable for any decisions that they make. \(^ \text{203} \)

**D. Are Stakeholder Adequately Protected?**

The previous section outlined three different ways that stakeholders are protected. This part will analyze the effectiveness of the outlined regime in protecting the interests of the three stakeholders most commonly impacted by control transactions: bondholders, workers and the local community. \(^ \text{204} \)

**i. Bondholders**

Of all stakeholders, bondholders have the greatest ability to protect their interests through contract. Bondholders represent a sophisticated group which can both foresee certain future events and negotiate effective protection. Bondholders not only have the ability to affect the

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**\(^{201}\) MacIntosh Fiduciary Duty, supra note 166 at 454.**

**\(^{202}\) Ibid.**

**\(^{203}\) Ibid.**

**\(^{204}\) Consumers, suppliers and the environment may also be impacted however this paper chose to focus on the three stakeholders likely to suffer the greatest injury during a change of control transaction.**
terms of the deal but have the realistic option of walking away from the table.\textsuperscript{205} In addition, change of control transactions represent events which the parties likely put their minds to when negotiating the agreement. Although not perfect, contracting provides a feasible option for bondholders to protect their interests from unfavourable control transactions.

ii. \hspace{1em} **Workers**

In contrast to bondholders, workers and employees represent a stakeholder group that may be unable to secure contractual protection. Professor Stone points to a number of obstacles that workers face in securing contractual safeguards against corporate restructuring including unequal bargaining power.\textsuperscript{206} The inability to effectively contract has resulted in a statutory framework aimed at protecting workers. Employees are covered by a “panoply of legislative instruments, including collective bargaining law, health and safety laws, plant closing law, unemployment insurance, governance retraining programs and so forth.”\textsuperscript{207} These laws ensure that employee interests are not disregarded by management.

In addition, of all stakeholders, workers likely have the greatest ability to influence governmental policy decisions. Unions are an example of a stakeholder group that has become organized and maintains considerable political clout.\textsuperscript{208} Although not all workers are part of a union, in Canada approximately one-third of workers are unionized and the legislative changes that are introduced by these groups benefit both unionized and non-unionized workers.\textsuperscript{209}

\textsuperscript{205} Zumbansen, supra note 193 at 17.
\textsuperscript{207} MacIntosh Fiduciary Duty, supra note 166 at 453.
\textsuperscript{208} Fisch, supra note 199 at 666.
iii. **Local Communities**

Like workers, local communities’ inability to contract effectively with corporations has resulted in insufficient protection of their interests. Although communities may be able to protect themselves through “bargaining with existing or prospective employers, offering firm tax abatements and other inducements in return for which they would and should extract promises about the firm’s conduct”\(^\text{210}\) often there are no express or implied understandings between corporations and the community.\(^\text{211}\)

The political process provides a viable technique for local communities to protect their interests. As pointed out by Macey and Millar “to the extent that actions of a firm are genuinely harmful to a local community, the members of that community can appeal to their elected representatives in state and local government for redress.”\(^\text{212}\) Legislatures are also better suited than boards of directors to protect local communities.

**E. Shareholders Bear the Greatest Risk**

The preceding outlined the various mechanisms that protect the interests of stakeholders. This part will argue that shareholders are only effectively protected through an exclusive fiduciary duty. Of all corporate constituents, shareholders find themselves in the position bearing the most risk.\(^\text{213}\)

Shareholders do not have the ability to contract with the corporation. When purchasing shares, the terms are set and there is no ability to alter them. The nature of shareholders’ residual

\(^{210}\) Bainbridge I, *supra* note 197 at 1443.

\(^{211}\) Macey and Miller, *supra* note 91 at 421.

\(^{212}\) *Ibid* at 422.

claim means that they are only entitled to what is left after all fixed claims have been paid off.\textsuperscript{214} As such, employees, creditors and suppliers will all be paid off before shareholders.

Given shareholders’ vulnerable position, they have a vested interest in monitoring directors. However, collective action problems prevent shareholders from having a meaningful voice in management decision-making.\textsuperscript{215} In addition, the widely dispersed nature of shareholders prevents them from monitoring directors effectively.\textsuperscript{216} These inherent difficulties involved in monitoring boards means that shareholders are left at the mercy of directors.

Professor Sheehy has argued that shareholders’ ability to sell their stock results in less risk compared to other stakeholders who are unable to leave their investment easily.\textsuperscript{217} Although shareholders are free to sell their shares at any point they will likely still bear the costs of director misdeed at the time of their exit. In addition, shareholders will not have all the necessary information to make a proper determination of whether or not to sell off their shares. Also, as pointed out by Minow the rise of institutional investors “has given us a class of shareholders who are just too big to sell out of a company every time they disagree with management.”\textsuperscript{218}

Shareholders inability to protect themselves through contract leaves them to rely upon legislative and market based protections. As argued above, although these types of protection may prove effective with regard to day-to-day decisions, control transactions provide a context where additional protection is necessary.\textsuperscript{219} Fiduciary protection is the most effective means of ensuring that shareholder interests are not subverted. As Professor Fisch has argued:

> Because the interests of managers, employees, creditors, customers, and suppliers, are adequately protected through other institutions, there is little need for judicial

\textsuperscript{214} Van Der Weide, supra note 168 at 57-58.
\textsuperscript{215} Bainbridge I, supra note 197 at 1442.
\textsuperscript{216} Bainbridge I, supra note 197 at 1442.
\textsuperscript{217} Sheehy, supra note 117 at 216.
\textsuperscript{219} See Section III Part A.
intervention. Shareholders, however, are relatively disabled from using these institutions effectively. As a result, shareholder primacy affords shareholders access to other institutional actors: the courts. Fiduciary duty cases provide a mechanism through which shareholders can trigger a lawmaking process that protects their distinctive interests.\textsuperscript{220}

Of all the institutions available to protect the interests of shareholders; courts are the best suited. Shareholders are not able to effectively mobilize and lobby government. Through devices such as securities class action, courts give individual investors a redress for any director misbehavior.

**Conclusion**

In conclusion, this paper has argued that directors should be required to focus exclusively on increasing shareholder value in the change of control context. This rule provides an enforceable standard for evaluating the actions of directors. As stakeholders have a variety of mechanisms to ensure that their interests are not disregarded, they are not in need of fiduciary protection. In contrast, shareholders face greater risks that validate a need to be protected by an exclusive fiduciary duty in the change of control context.

*Peoples* and *BCE* seem to steer Canadian corporate law towards a more stakeholder friendly model. Although there is some merit to a more holistic approach to corporate governance, questions emerge as to whether the courts are the best institution to make such fundamental policy decisions. The *BCE* decision overstepped its boundaries when rendering a decision that effectively uprooted fundamental principles and assumptions of Canadian corporate law. As commentators have pointed out, although the committee drafting the *CBCA* foresaw an active role for courts in defining the boundaries of corporate fiduciary duties, there is no evidence that it intended to displace fundamental tenants of the corporate legal system.\textsuperscript{221}

\textsuperscript{220} *Fisch, supra* note 199 at 668.

\textsuperscript{221} Jeffrey MacIntosh, “The Peoples corporate law: unsafe at any speed” *National Post* (10 June 2008) (“There is every indication in the legislative report of the committee that drafted the provision (outlining directors’ fiduciary duties), however, that the committee embraced shareholder primacy as the bedrock of corporate law.”)
The current corporate governance system in Canada is shareholder focused. The overarching role of shareholders in corporate governance is the result of not just fiduciary duties, but the other market and legal mechanisms. Shareholders have the ability to vote on many fundamental transactions and are free to call a meeting and discharge a board. Securities law also places a significant importance on protecting shareholder interests in the change of control context. There are also a variety of other market forces that align the interests of directors with that of shareholders.\footnote{222 See Section III Part 1.}

If Canada prefers to introduce a corporate governance model that places more focus on stakeholders, fundamental changes to corporate and securities laws are required. Simply altering the fiduciary duty is not enough. All the Supreme Court has achieved by altering the content of the fiduciary duty is creating an indeterminate standard which compromises the ability to effectively monitor boards of directors.

In addition, the decision as to whether a stakeholder or shareholder approach should be adopted in Canada is better undertaken through parliamentary process. When the United Kingdom decided to alter their corporate fiduciary duties, they commissioned a parliamentary committee to research and recommend a course of action.\footnote{223 See generally, Sarah Worthington, “Reforming Directors’ Duties” (2001) 64 Mod. L. Rev. 440.} The changes were debated in parliament and ultimately approved. Given the complicated nature of corporate regulation, parliament is better suited at making fundamental policy changes.

Professor Ziegel has questioned the ability of the Supreme Court to effectively deal with private law appeals. He notes that the private law cases are rarely in front of the court whose major focus is on criminal and constitutional issues.\footnote{224 Jacob Ziegel, “The Peuples Judgment and the Supreme Courts Role in Private Law Cases” (2005) 41 C.B.L.J. 236 at 243-244.} In addition, many of the justices do not
have corporate law backgrounds.\textsuperscript{225} A preferable approach for the Supreme Court in *People* and *BCE* would have been to follow the traditional and foundational doctrines in place and leave any fundamental changes to the legislatures. Unfortunately this was not the case and we are now left waiting on subsequent courts to further specify the content and operations of the uncertain BCE duty.

\textsuperscript{225} Ibid at 245.