CORPORATE DIRECTORS’ DUTIES AND ECONOMIC PROTECTIONISM

THE CANADIAN EXPERIENCE

by

Hadir Elhakim

A thesis submitted in conformity with the requirements
for the degree of Masters of Law
Faculty of Law
University of Toronto

© Copyright by Hadir Elhakim 2013
Corporate Directors’ Duties and Economic Protectionism

The Canadian Experience

Hadir Elhakim

Masters of Law
Faculty of Law
University of Toronto

2013

Abstract

An analysis of company law may allow us to abandon a perception that company law is impartial to the political context in which it is applied. This paper argues that state protectionism is reflected in the design of company law. Specifically, states may confer public functions to board of directors through their duties and authorities; in turn, directors’ functions may become barriers to foreign investments.

To illustrate this argument, focus is placed on the duties of Canadian corporate directors and how their functions affect foreign direct investment in Canada. It demonstrates that the public function conferred to corporate directors echoes the State’s policy and regulations governing foreign investment. As a consequence to the redundancy of the public interest rationalization and the lack of political will to affect real market openness, unnecessary barriers are being placed for market access which may ultimately render Canada less attractive for foreign investors.
Acknowledgments

I would like to thank Professor Edward Iacobucci for supervising the writing of this thesis. I owe the deepest appreciation to my parents, Ashraf and Sawsan, for their continuing and unconditional love and support. Finally, I wouldn’t have pursued my LLM without the support of my partner, Ahmed Hafez. I thank him for an ever exciting journey and for always believing in me.
# Table of Contents

Acknowledgments........................................................................................................................................ iii

Introduction.................................................................................................................................................. 1

I- Setting the Scene...................................................................................................................................... 3
   A- Revival of Economic Protectionism ........................................................................................................ 3
   B- Formal Barriers to FDI............................................................................................................................ 4
   C- Corporate Law as a Protectionist Tool .................................................................................................. 6
      1- Economic Protectionism and Company Law Design .................................................................. 6
      2- Private Powers as State’s Surrogate................................................................................................. 6

II- Interplay between Corporate Directors’ Power and FDI ...................................................................... 8
   A. Evaluating the Power of Corporate Directors ...................................................................................... 8
      1. Corporate Directors’ Duties ............................................................................................................... 9
      2. For Whose Benefit are Corporations Run? ...................................................................................... 10
      3. Court Deference to Directors’ Business Judgment ......................................................................... 12
   B. Corporate Directors’ Power and Foreign Investments ......................................................................... 13
      1. Impact of Directors Duties on Foreign Investments ..................................................................... 14
      2. Directors Duties and Foreign Takeovers .......................................................................................... 15

III. Canadian Protectionism: Redundancy of the Public Interest Rationalization ....................................... 18
   A. Screening Process for Foreign Investments ......................................................................................... 19
      1. The Net Benefit Test ....................................................................................................................... 20
      2. Criticism to the Net Benefit Test .................................................................................................... 21
   B. Power of Corporate Directors ............................................................................................................ 22
      1. Confirming Stakeholder Primacy as Law ....................................................................................... 22
      2. Deference to Directors’ Business Judgment .................................................................................... 27
3. An Assessment of the Corporate Directors’ Power ........................................... 31

C. Case Study: Exactly How Much Power Does the Board Have?.......................... 33
   1. Background of BHP Billiton’s Bid for PotashCorp...................................... 33
   2. PotashCorp’s Defensive Tactics .................................................................... 34
   3. ICA: Is the Deal in the Net Benefit of Canada?.......................................... 35
   4. Empowering Corporate Directors with a Bigger Arsenal ......................... 36

D. An Analogy between ICA and BCE ................................................................ 37
   1. Corporate Directors’ Function Echoing State’s Protectionist Policy ............ 37
   2. Discretionary and Undue Application of the Public Interest Rationalization.... 38

E. Ramifications of the Public Interest Function and Investors’ Undertakings ....... 39
   1. Impact on Financial Interest ........................................................................ 39
   2. Impact on Strategic Interest ......................................................................... 42

IV. Concluding Notes ............................................................................................. 45

Bibliography .......................................................................................................... 48
Introduction

In recent decades, global competition has become increasingly aggressive, with new markets opening up, new economies taking the lead and innovations and new technologies being constantly introduced. Unsurprisingly, in what seems like an impulsive reaction to the growing global competition, states tend to protect their markets, to give precedence to their local investors, contractors, employees and communities while placing restrictions and barriers in the way of foreign investors. Although this tendency to protect the local markets is far from being new, nonetheless, the novel techniques by which states place obstacles before foreign entrants offer an interesting material to discover.

Within this framework, foreign direct investment (FDI) faces various obstacles placed by states, which may not expressly prohibit the entry of foreign investment but nonetheless increase the cost and hurdles to enter into and to benefit from the investment made in a foreign market. However, with this market protection comes a decrease in competition and ultimately, this creates a suboptimum business environment for investors and is also to the detriment of local consumers and communities.

The emphasis of this paper is on barriers to FDI and will specifically depict a nontraditional barrier to foreign investment which emanates from company law. At its core, it argues that in addition to regulatory measures taken by governments to protect local market from foreign competition, private powers may be entrusted with broad public mandates.

Specifically, the paper assesses whether the power of corporate directors may have an impact on foreign investment. In order to do so, an initial understanding of corporate directors’ duties and authorities is necessary; thereafter, an assessment of those powers is made through the lens of a foreign investor and how boards’ functions may affect the investors’ decision to enter a particular market. Such impact may be either due to the authorities of a target board to decide on a foreign bidder’s market entry and may also be following entry of a market if the mandate of the foreign shareholder’s board representative is not aligned with their financial or strategic interests.

This paper is divided into three parts. Part I will present the outline within which the core argument of this paper is made with particular focus on the revival of protectionism. In addition
to giving a brief account of traditional barriers to foreign direct investments, it will shed on light on how company law can be used as a protectionist tool. Subsequently, Part II will focus on the relation between corporate directors’ duties and foreign investments. To this end, it will tackle a central question in company law: to whom does the board owe its duty to? In answering this question, states define the corporate objective to focus either on economic efficiency or on public interest. As noted, the different objectives come into play when foreign investors are involved, both at the entry phase as well as upon becoming a foreign shareholder in the market.

Canadian corporate directors’ duties and authorities are of central focus in Part III of this paper, especially with the growing concern during recent years regarding whether or not Canada is open to foreign investment. This was mainly due to the much debated Investment Canada Act (ICA) which regulates foreign investments and provides discretionary power to the Minister of Industry. This Part will present an analogy between the function of corporate directors and that of the Minister of Industry under the ICA. In doing so, it concludes that corporate fiduciary duties in Canada have evolved to reflect a focus on “the public interest”; accordingly corporate directors are now entrusted with broad public functions and greater powers than merely being managers of private entities.

Finally, in the concluding notes, it is argued that the redundancy of the public interest function used by the state as well as by the private powers may hinder the long term progression of the Canadian economy.
I- Setting the Scene

A- Revival of Economic Protectionism

Although globalization is not a new concept, yet it still provokes fierce sentiments; particularly, fear of loss of national sovereignty has been at the forefront of concerns relating to free capital movement. Amongst the areas of capital flow raising most concern are FDI, since they involve the control of domestic firms by foreign corporations.

To be sure, there is an increasing consensus on the benefits of inward FDI and its potential in making significant contributions to the economy; among other things, it is considered a source of technology transfer and spillovers, investment in human capital and local employment and a necessary source of capital for natural resources extraction projects.

Nevertheless, FDI have long been viewed as a form of economic imperialism. Particularly in certain sectors, they have raised cultural and political sovereignty concerns. They have also raised concerns relating to national security, particularly with the increased activity of Sovereign Wealth Funds (SWF) and State Owned Enterprises (SOEs), out of fear that such entities can access national security or technology information through the acquisition of foreign entities.

---

1 OECD (Organization for Economic Co-operation and Development) “Benchmark Definition of Foreign Direct Investment” (2008). Paris: OECD. 4th ed. Available at <http://www.oecd.org/daf/inv/investmentstatisticsandanalysis/40193734.pdf>. The Organization for Economic Co-operation and Development (OECD) provides the following formal definition for foreign direct investment (FDI): “FDI..... is a category of investment that reflects the objective of establishing a lasting interest by a resident enterprise in one economy (direct investor) in an enterprise (direct investment enterprise ) that is resident in an economy other than that of the direct investor. The lasting interest implies the existence of a long-term relationship between the direct investor and the direct investment enterprise and a significant degree of influence on the management of the enterprise. The direct or indirect ownership of 10% or more of the voting power of an enterprise resident in one economy by an investor resident in another economy is evidence of such a relationship.”


3 Ibid


5 For instance oil and gas, mining and telecommunication.

6 Trebilcock and Prado, Supra note 4 at pp 243.
Indeed, the World Bank had reported in 2009 that the world’s major economies were imposing protectionist measures in response to global economic slowdown.\(^7\) Such measures were taken notwithstanding the pledge made by the heads of state of the G20 to refrain from imposing any protectionist measures following the 2007/2008 financial crisis.

On that note, despite the frequent use of the term “protectionism”, the notion has been said to lack specific definition. Quite the opposite, the term has been described to capture “a general picture and a number of specific actions that could potentially be protectionist”.\(^8\) Traditionally, it has been used to include imposing tariffs, offering government subsidies and imposing quotas on traded goods. Others have suggested that the definition should be expanded to include other restrictive government regulations which protect local economies at the expense of global trade.\(^9\)

**B- Formal Barriers to FDI**

Although many economies consider FDI as an essential part of their development strategies, research conducted by the Organization for Economic Co-operation and Development (OECD) demonstrates that OECD countries still place barriers on inward FDI. As noted, such barriers are typically placed in response to concerns over the loss of national sovereignty and foreign control over national economy. In a revised research issued in 2010,\(^10\) the OECD examined regulatory policies affecting international investment based on an up-to-date description of countries’ FDI regimes as well as a broader range of sectors and furthermore, it revised the way in which FDI measures are scored and weighted.


\(^9\) John Authers, “Short View: Defining Protectionism” (February 2nd 2009); Financial Times Available at: <http://www.ft.com/intl/cms/s/0/c70dade6-f157-11dd-8790-0000779fd2ac.html#axzz2VvZsa1O1>

Based on the research, the FDI Restrictiveness Index takes into account four types of measures: (i) equity restrictions, (ii) screening and approval requirements, (iii) restrictions on foreign key personnel, and (iv) other operational restrictions.

Limitations on foreign ownership, through the limitation of share ownership for non-residents in target sectors are thus amongst the common formal FDI barriers; targeted sectors generally include airlines, telecommunications, energy, mining and media. Similarly, obligatory screening and prior approval procedures are also employed to limit FDI; they usually increase the cost of entry and may discourage inflow of foreign capital. The most restrictive form is one which applies economic needs test, net economic benefit or national interest tests to both start-ups and acquisitions.

Likewise, imposing limitations on foreign key personnel have also been recorded (including those related to directors, managers and other key personnel). Such restrictions may include economic needs tests for the employment of foreign managers, time bound limits on the employment of foreign managers as well as nationality requirements for members of the board of directors. This may also take the form of stipulations that nationals or residents must form a majority of the board of directors which is said to undermine foreign owners’ control over their holdings.

The OECD 2010 report also elaborates on other various restrictions which affect the potential operations of foreign investors. These measures include restrictions on the establishment of branches; restrictions on land acquisition for business purposes, reciprocity clauses in particular sectors and restrictions on profit or capital repatriation.

In addition to these formal barriers, the OECD 2002 Report had referred to ‘opaque informal public or private measures’ used as informal barriers to limit foreign ownership of domestic businesses.\(^\text{11}\) In the present paper, focus will be made on such private measures employed by corporate board directors as informal barriers to foreign investors.

\(^{11}\) OECD 2002 Supra note 10
C- Corporate Law as a Protectionist Tool

1- Economic Protectionism and Company Law Design

Beyond the formal FDI barriers, a deeper analysis of company law reveals how its design may be affected by economic protectionism.\textsuperscript{12} Certainly, corporations have become central players in capitalist societies; their effects reach beyond the immediate financial interests of their owners to the broader economic and social welfare of a country. This being the case, there is a need to have proper regulations governing such influential entities\textsuperscript{13} and aligning the objectives of corporations with the overarching public policies. In this context, the design of laws governing corporations has taken front and center, particularly since the financial crisis of 2007/2008.

Indeed, the manner by which economic protectionism affects the design of company law is reflected in several legislations and regulations. For instance, in 2010, following the takeover of British Cadbury by the American Kraft, proposals were made to review the City Code – the takeover regulatory framework in the UK- to ‘prevent hostile takeovers of British companies which are not in the public interest’ and to make takeovers more difficult. Similarly, concerns relating to economic sovereignty have also been repeatedly emphasized in recent years following the increase in the number and activity of SWFs and SOE. In response to such threats, various measures are set to limit access to national markets or deter foreign investments on the government level including heightened pre-entry screenings criteria and national security review.\textsuperscript{14} At the private level, the design of company may delegate to those who control corporations with a broad public function to consider and respond to public concerns.

2- Private Powers as State’s Surrogate

According to Rickford,\textsuperscript{15} protectionism in company law can take two forms: the first is through actions taken by the government to protect the national market from foreign competition, particularly in markets for capital and corporate control; this is usually justified as a social

\textsuperscript{12} Bernitz and Ringe, supra note 8
\textsuperscript{14} Bernitz and Ringe, supra note 8 pp 3
\textsuperscript{15} Jonathan Rickford, ‘Protectionism, Capital Freedom and the Internal Market’ in Bernitz and Ringe, supra note 8 pp 54.
policy. Alternatively, protectionism can be used by corporate directors to protect themselves from foreign takeovers; in this case, they use corporate interest as a justification.

To illustrate, following the financial crisis of 2007/2008, national governments in the US and the EU both attempted to link bailouts, state rescues and subsidies to policies of the failing corporations to save jobs in the local market and gave priority to local contractors.16 This demonstrates how governments can use social policy as grounds to protect the local market from foreign competition. Similarly, in relation to empowering corporations to shield themselves from foreign bidders, the EU Directive on Takeover Bids17 certainly reflects how EU member states wanted to allow similar measures in the private law domain.18 A brief examination of the powers granted to corporate directors through the Directive will be addressed in a later section.

As noted, it is those private powers that the present paper is concerned with. Specifically, those private powers come into play in cases where, in certain jurisdictions, company law confers to the boards of directors a wide range of interests to consider. Canada is used in the final section of the paper as a model where directors are required to consider different stakeholders upon making a decision in the best interest of the corporation. However, given that the best interest of the corporation is as a broad notion, corporate directors are thus entrusted with broad and discretionary powers. Accordingly, to maintain control over the corporation, directors may decide to use their public function to justify actions shielding the corporation from any acquisition.

As a result, it has been said that the board’s function becomes a ‘surrogates’ for the state when private parties are entrusted with public functions under private law.19 By way of example, the reciprocity power which allows directors to block a bid from a company with a less open structure than its own under the EU Takeover Bids Directive is an illustration of a situation where private parties are entrusted with public functions; particularly, when the allegiance of the

18 Jonathan Rickford, ‘Protectionism, Capital Freedom and the Internal Market’ in Bernitz and Ringe, supra note 8, at 54-94
19 Ibid
private powers are not limited to the interest of the shareholders but rather a wider range of constituencies and the public interest.\textsuperscript{20}

In conclusion, an assessment of the duties and authorities conferred upon those who manage corporations, specifically boards of directors, may allow us to reconsider whether company law is impartial and rather consider the subtle objectives for which it can be used. It has been fairly stated that “\textit{Law can be used and is used for political purposes: it defines the cornerstones of our capital societies, but it may also be used to shield them against influence from other nations and against each other}.”\textsuperscript{21} With that in mind, a demonstration of the interplay between such private powers and economic protectionism will be made in the following sections.

\textbf{II- Interplay between Corporate Directors’ Power and FDI}

\textbf{A. Evaluating the Power of Corporate Directors}

The design of company law is critical due to the significant economic and social role corporations play in modern day economy. It sets the relationship between a company’s management, its board, its shareholders and other stakeholders. At its core, company law provides the corporate objectives and the means of attaining such objectives.

Directors play a central role in corporations. They are members of the board and are granted a wide range of powers to manage the company. For instance, their role includes determining the objectives of the company’s business, in terms of strategic planning and risk management; they consider important management decisions, provide direction to the company and report to the shareholders. In this context, the central debate has been how directors run the company and for whose benefit.\textsuperscript{22} The framing of the directors’ duties and authorities is central to our understanding of how they become influential private powers.

In effect, there are three elements that define the function and authority of boards of directors: i) their legal duties for which they are accountable, (ii) to whom the duties of the board are owed,

\begin{footnotes}
\item[21] Bernitz and Ringe, \textit{supra} note 8 at pp 9.
\end{footnotes}
which in essence identifies the corporate objective and iii) the amount of deference given to boards’ decision. These elements allow us to identify exactly how much power corporate directors are granted.

1. Corporate Directors’ Duties

Directors’ duties of publicly held corporations are defined differently in various jurisdictions but, in essence, they require that directors bear a certain degree of care. In France, for instance, managers and directors are held to a duty of care and are held liable before the company or third parties for infringements of the laws and regulations applicable to the company, for breaches of the articles of association or for tortious or negligent acts of management.\(^{23}\) Germany requires that “the directors must give the care of a competent businessman to the affairs of the company…directors who commit a breach are jointly and severally liable to the company to the resulting damage”.\(^{24}\)

In the UK, the directors of a company are under a duty to exercise reasonable care, skill and diligence; this duty is owed to the company. Generally, the assessment of whether the director has breached his duty is objective to the extent that “the director’s conduct will be compared with the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions which are performed by the director”.\(^{25}\) Finally in the US,\(^ {26}\) directors of corporations have two primary duties towards the Company and its shareholders, namely the duty of care and the duty of loyalty. The duty of care requires the directors to perform their duties with appropriate care so as to avoid injuring the corporation; the duty of loyalty on the other hand requires that directors put the interest of the corporation ahead of their own.\(^{27}\)

In brief, corporate directors are responsible for the direction and management of the corporation with appropriate care and loyalty; failure in fulfilling their duties would render them accountable.


\(^{24}\) Ibid at 36.

\(^{25}\) Ibid at 45-51.

\(^{26}\) Reference here is made to the laws of Delaware, whereas Delaware is the most popular state for incorporation of public corporations in the US and is recognized as the most sophisticated corporation law in the US. Siems and Cabrelli (eds), supra note 23 pp 52.

\(^{27}\) Siems and Cabrelli, supra note 23 at 27-60.
for their breach. The question here is to whom are they held accountable? The debate on whether they owe their duties to shareholders or to a wider range of constituencies illustrate the different views on corporate objectives, and whether corporations should be concerned with public policy or rather remain focused on financial efficiency.

2. For Whose Benefit are Corporations Run?

Corporate objectives have been subject to two main theories: the shareholder value and the stakeholder value. A brief examination and understanding of both theories is central to this paper; both theories reflect different corporate objectives, which as per the claim presented here, may be reflective of the states’ protectionist policies.

It is to be noted here that both theories have their advantages and shortcomings, but it is not the purpose of the paper to consider such angle of the debate. Rather, the purpose is to highlight the aspect of each theory that may affect the power granted to corporate directors.

i. Shareholder Theory

Shareholder theory - also referred to as shareholder primacy or shareholder wealth maximization - mainly holds that the managers are to maximize shareholders’ wealth. As a result, the directors’ role is focused on economic goals and they remain accountable to shareholders. With regards to other stakeholders, they may be taken into consideration, but only as a secondary responsibility. To be sure, the interests of stakeholders other than shareholders are only relevant to the extent that they contribute to the maximization of the shareholders’ wealth.

The shareholder primacy theory is primarily argued for because shareholders have residuals claims in the company; this means that they will benefit from an increase in the corporation’s wealth, but will also be the last to be paid in case of liquidation. Hence, they bear the greatest risks from the decisions taken by the management and are most worthy to decide on the company’s policy. Further arguments in favor of this theory claim that focusing on shareholder value is beneficial to society as it increases social wealth; particularly, other constituencies
benefit from directors’ focus on maximizing shareholders’ wealth, thus there’s no conflict between shareholders and stakeholders’ interests.\textsuperscript{28}

\textbf{ii. Stakeholder Theory}

Conversely, the stakeholder theory provides that the directors should consider the interest of all stakeholders including the shareholders. This theory is centered on the premise that, first, other constituencies contribute to the success of the corporation and that there are others who are affected by the company’s actions and decision; put differently, this theory argues that stakeholders make investments in the company just like shareholders. Second, failing to consider stakeholders other than shareholders will lead to their lack of commitment and to the withdrawal of their investments and support to the company; in other words, it is argued that if stakeholders are shown loyalty and respect, the company and shareholders would benefit more and produce greater social wealth.\textsuperscript{29}

Moreover, it has been argued that ‘a stakeholder approach in general terms is premised on the notion that inclusion from a social, economic and political perspective is valuable; and the theory focuses on fostering the full potential of all contributors. Similarly, it was asserted that ‘the economic and social purpose of the corporation is to create and distribute wealth and value to all its primary stakeholder groups without favoring one group at the expense of others’.\textsuperscript{30}

Accordingly, the role of directors under the stakeholder theory has been described as that of mediators who attempt to balance the different interests at stake, while taking into consideration the social, economic and political setting. With that in mind, the difficulty of this theory lies in its lack of practicality. First, there are no guidelines to assigning weight to the interests of the stakeholders; additionally, given the range of interests to consider, there’s no specific objective on which directors should focus, a matter which grants them broad discretionary power. More importantly, there’s no definition for stakeholders; in fact, the concept has been described as being vague and blurred.\textsuperscript{31}

\begin{footnotesize}
\begin{enumerate}
\item Keay, supra note 22 at 15-42
\item Keay, supra note 22 at 42-52
\item \textit{Ibid}
\item \textit{Ibid}
\end{enumerate}
\end{footnotesize}
Given the comparison between both theories, it is clear that a key advantage in the shareholders theory, particularly when considered by a foreign investor, is that it focuses on the corporation’s economic efficiency and provides directors with a clear objective, which is solely centered on the economic performance of the corporation. Moreover, the stakeholder theory may not permit shareholders to have efficient control over their investments, particularly if they do not have controlling power or are not sufficiently represented on the board to affect decisions aligned with their interests. Either way, the extent with which a business decision or action is respected defines the degree of authority of a board of directors.

3. Court Deferece to Directors’ Business Judgment

As discussed, different jurisdictions define directors’ duties in relatively broad terms generally requiring directors to act with due care upon taking actions in their directorial capacity. With varying standards applied to fulfill such duties, it has been demonstrated that the evaluation of directors’ conduct and the resulting outcome will depend on the deference granted by courts to the business judgment of directors if their decisions are contested.  

The ‘business judgment rule’ (BJR) is widely used by courts to defer to the business judgment of the directors under certain conditions. In the US, where the doctrine originated, corporate directors are not held responsible for errors in judgment while acting in their capacity as directors as long as they can demonstrate that they exercised their judgment in good faith, with due care and using sound business judgment. Under such circumstances, the courts would defer to the directors’ judgment and would not replace their analysis for the directors’ decisions, which may not be ideal but justified under specific circumstances.  

32 Theis Klauberg “General Case on Directors’ Duties” in Siems and Cabrelli, supra note 23 at 27-60
Furthermore, several jurisdictions adopt the BJR, whereby the directors’ actions are evaluated as to their merits only in the event of losses borne by the company. In such cases, the standard of care is generally met if the directors can prove that they took acceptable responses to the circumstances at hand. However, the evaluation of the duties and whether or not they have been met by the directors depends on the discretion granted by courts in the application of the BJR.

In brief, this section expanded on the different theories of corporate fiduciary duties and sheds light on how the broadness of the corporate objective, particularly in the stakeholders theory, leaves board directors with broad discretionary power to fulfill a vague objective. More importantly, the application of the BJR, by which the courts defer to the decision of the board, may give further leeway to directors in the direction of the corporate objective.

Given the authority with which boards are empowered, the relation between such authority and foreign investments needs to be clarified. In that context, foreign takeovers are used as an example where corporate directors’ powers come into play, particularly where they have a great influence on the outcome of a takeover. This scenario certainly reflects the subtle role that company law plays, by granting public functions to private powers, which ultimately results in the same ends sought by states.

B. Corporate Directors’ Power and Foreign Investments

In this sub-section, I will first examine how the authorities of board of directors could financially and strategically impact foreign investors. Then, I will examine in general terms takeover regulations and their relation to economic protectionism. To illustrate, I will briefly consider

34 Other examples of jurisdictions applying the BJR: In the UK, generally, the courts are apprehensive to the avoid application of hindsight bias and are aware that ‘they are not equipped to second-guess the commercial judgment of directors’. (Theis Klauberg “General Case on Directors’ Duties” in Siems and Cabrelli, supra note 23 at 27-60). In Germany, a revised version of the BJR and the case law gives directors the benefit of a business judgment rule whereby ‘Negligence is not given, if the board member reasonably can assume, that it acts on the basis of adequate information to the benefit of the company’. Online at <http://prof-hoffmann.de/en/allgemein-en/business-judgement-rule/> (Last visited June 7th 2013). French courts also have wide discretion to decide the amount of breach of duty of care; managers and directors are held to an objective standard, as in they are compared to “what a reasonable manager or director would have done in the same situation”. Generally, French courts tend not to second-guess the board’s decision as long as the company remains solvent, which may be considered similar to the business judgment rule. (Siems and Cabrelli, supra note 23 at 33-34)

35 Theis Klauberg “General Case on Directors’ Duties” in Siems and Cabrelli, supra note 23 at 27-60
rules relating to foreign takeovers in the US\textsuperscript{36} and the EU Takeover Directive. As noted, I will consider in the final part of this paper Canada to examine the interplay of fiduciary duties and foreign investment in more detail.

1. Impact of Directors Duties on Foreign Investments

In the context of foreign investments, given the extent of authority entrusted to board directors in different jurisdictions, it is imperative to consider two scenarios: first, when a foreign bidder targets a corporation in a foreign jurisdiction, it is imperative to discern the actual function of the board of the targeted jurisdiction; as in, the foreign bidder should be made aware of whether the particular jurisdiction allows or mandates board members to consider constituencies other than shareholders. Certainly, this would have an effect on both the strategic approach as well as the financial commitments of the foreign bidder. Furthermore, the amount of deference given by courts to directors’ decision would give further indication on whether boards may use their public function to justify the rejection of a foreign bid.

Secondly, foreign shareholders should consider their duties and authorities upon entering a foreign market. They should consider whether their board representatives will be bound by the economic interests of shareholders or a set of broader interests to consider. In the latter case, it may be argued that it would become more difficult and costly for investors to fully benefit from their investments, particularly in circumstances where they are not a majority, if they do not have sufficient representation on the board or lack the means to challenge the decisions of the directors. Finally, foreign investors should consider whether their duties and authorities as board representatives would be equal to those granted to directors with local residency.

In both scenarios, it should be noted that duties and authorities of foreign investors should be considered in the context of the overall existing legal and regulatory environment governing foreign investors.

\textsuperscript{36} The US is used to illustrate particularly due to the wide range of defensive tactics that can be used to block a takeover; this includes poison pills and staggered boards which ultimately allows the board to ‘just-say-no’ to a takeover. Additionally, the application in the business judgment rule in the US grants high deference to the board’s decisions.
2. Directors Duties and Foreign Takeovers

Takeover regulations have an essential role in increasing protectionism. To demonstrate how directors’ roles may affect foreign takeovers, two examples are demonstrated: first, in the US, the ‘directors’ primacy’ model grants corporate directors a combination of tools which empower boards to reject unwanted bids; those tools would equally allow corporate directors to block any foreign bidder from acquiring any local corporation. Secondly, the experience of the EU Takeover Directive is raised, where the creation of the Directive reflects how member states want to empower board directors and maintain their right to affect the outcome of a bid.

a) Boards’ Defensive Tactics in the US

To start with, it was argued in the US that ‘hostile takeovers encourage short-termism, predatory conduct by professional investors, harmed stakeholders and the community and constituted a fundamental attack on the central role of the board under the US corporate law’.  

This argument had seemingly paved the way for the *Unocal Corp v Mesa Petroleum Corp* decision; in fact the Court held that a board of directors may try to prevent a take-over where it can be established that there was a threat to corporate policy and the defensive measure adopted was proportional and reasonable. This reasonable relation analysis included the analysis of the impact on shareholders, creditors, customers, employees, and the community. However, the permission to consider other constituencies was later restricted by *Revlon Inc. v MacAndrews*; in this case, the Court decided that in circumstances where the company was up for sale, directors’ duties should be centered on obtaining the highest price for shareholders.

Nevertheless, as noted, the BJR impedes shareholders from challenging the management decision as long as such decision was made based on sufficient information and in good faith. Furthermore, with regards to takeover defenses, the Delaware Supreme Court has typically

---

38 Unocal v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985)
declared the poison pill to be valid and has only in rare cases rejected its use.\textsuperscript{41} Accordingly, the decision to implement a change of control in Delaware lies mostly in the hand of boards of directors.

In summary, the ‘director’s primacy’ model in the US, with its deference to the directors’ decision, leaves any change of control to the directors’ discretion. Certainly, upon assessing the tools made available for corporate directors in the US, it may be prudent to claim that the combination of defensive measures, the staggered boards in the US and the BJR leads to the creation of challenging barriers to market access through hostile takeovers.

b) EU Takeover Bid Directive

The purpose of the EU Takeover Bid Directive was ‘the integration of national economies constituting the market and to enhance the competitiveness of European industry as against non-European rivals by facilitating takeover bids, especially cross-border ones’.\textsuperscript{42}

Of particular interest is the Board Neutrality Rule (BNR), which precludes directors of target companies to engage in certain conduct that result in the frustration of the offer made by the bidder without obtaining the prior consent of the shareholders. Additionally, the Directive introduced the concept of ‘reciprocity’ whereby a Member State may allow companies subject to the BNR to be discharged from the BNR if they receive a bid from an acquiror not subject to the same restriction.\textsuperscript{43}

The BNR had stirred a long debate between member states, due to objections against making such rule mandatory. It was in fact blamed to be a central cause of failure of the 1996 proposal of the Directive. It was not until 2001, when an agreement was reached allowing members to opt out of the BNR, that the Directive was passed.\textsuperscript{44} The latter provides flexibility to the member states in deciding whether and how to implement the rule when transposing the text into their

\textsuperscript{41} Hill, Jennifer G., Takeovers, Poison Pills and Protectionism in Comparative Corporate Governance (November 7, 2010)
\textsuperscript{42} Paul Davies, Edmund-Philipp Schuster and Emilie van de Walle de Ghelcke, “The Takeover Directive a Protectionist Tool?” in Bernitz and Ringe supra note 8 at 105-160
\textsuperscript{43} Ibid
\textsuperscript{44} Ibid
national legal system. However, Member States who decide to opt-out of the BNR must allow companies the right to implement the BNR in their bylaws.45

Ultimately, the EU Takeover Directive led to a substantially diverse framework in which member states adopted their own preferences to their regulatory regimes.46 The experience of the Directive is said to reflect the protectionist stance in response to the populist fear of globalization.47 Notably, it reflected how states, particularly those who eventually opted out, wanted to empower private powers with the tool to limit foreign takeovers. It granted corporate directors a public function which in essence should be entrusted to the states.

In summary, the design of company law may indeed be affected by the national policy direction, particularly in relation to foreign investments. As has been elaborated, company law may grant corporate directors with broad powers; such powers risk being used arbitrarily if directors are also allowed to take into consideration public policy concerns upon making their decisions. Inevitably, such powers affect foreign investors’ decision to enter a market, particularly when such powers become genuine barriers to foreign investors.

The upcoming section will consider corporate fiduciary duties in Canada through a foreign investor’s lens. Therefore, the impact of directors’ duties on market access as well as upon entry will be analyzed in the context of a broad set of laws affecting foreign investors.

45 Pablo Iglesias-Rodriguez “Obligations of Directors in Takeovers” in Siems and Cabrelli, supra note 23 at 83-124
46 Ibid
47 Hill, supra note 37.
III. Canadian Protectionism: Redundancy of the Public Interest Rationalization

Canada is ranked amongst the most restrictive places for inward FDI by the OECD in comparison with other OECD countries as well as amongst 14 other non-OECD countries. Amongst the main causes for this ranking is the screening and approval process for all foreign investments over a specific threshold under the Investment Canada Act (ICA).

Certainly, in recent years, the ICA has stirred debate on whether Canada is open to foreign investments. The ICA provides for the ‘net benefit test’ which is considered a highly subjective and unpredictable test. The Act requires that foreign investors demonstrate the economic benefit of their acquisition of a Canadian corporation and to make undertakings which inevitably increases the cost of entry. Moreover, the government’s position with regards to several takeover transactions has sent mixed messages with regards to its approach to FDI.

In addition to the ICA, Canada’s restrictiveness has also been attributed to other causes including constraints on the ability of foreign nationals either to manage or to work in affiliates of foreign companies; nationality or residency requirements for the majority of the board of directors and restrictions on foreign ownership in specific sectors.

Nevertheless, while the focus has been mainly on the ICA, not much attention has been given to other restrictions. Given the scope of this paper, focus in this part will be on board fiduciary duties and how they affect foreign investment. To do so, Section A will briefly present the much contested ICA and highlight the main criticism against the Act. Section B will then assess in detail the duties and authorities of directors. Then, a case analysis will be presented in Section C, highlighting how both the regulatory framework and private powers come into play with foreign investments.

Through a foreign investor’s lens, an analogy will be made between the regulatory framework and private powers. In conclusion, section D provides that private powers have evolved to echo the public policy in relation to foreign investments, particularly with a redundant reliance on the

---

49 Ibid.
public interest justification to resist foreign investors. Finally, in Section E, a question on how corporate directors’ authorities impact the financial and strategic interests of foreign investors is raised.

A. Screening Process for Foreign Investments

The ICA\(^{50}\) is the act which regulates FDI in Canada. The purpose of the Act, as it states, is to review ‘significant investments in Canada by non-Canadians’ in a manner that would promote foreign investment, economic growth and employment opportunities. The ICA offers three separate processes: notifications; the economic review under the ‘net benefit test’; and national security reviews.

Although there are a number of factors which determine the applicable process, the main determinants are the structure and the value of the transaction as well as the nature of the assets of the Canadian business being acquired. A notifiable transaction would simply require the foreign investor to fill out a standard form notification with basic information about the investor; this administrative formality may be filed up to 30 days after the implementation of the investment. The national security review may be required despite of the value of the investment where there are reasonable grounds to believe that the investment may be injurious to national security. Such review may be initiated by the government which may prohibit the investment or even require the divestiture of a completed investment if it is found to threaten national security. Although ‘national security’ is not defined in the ICA, causing concern relating to the unpredictability of the review, the national security review has not to date been attributed as a protectionist barrier to investment. \(^{51}\) Conversely, the most debated review is certainly the economic review, which requires that the foreign investment to be in the “net benefit” of Canada.

\(^{50}\) Investment Canada Act, RS 1985, c 28 (1st Supp).[ICA or the Act]

1. The Net Benefit Test

The ‘net benefit test’ applies when there’s an acquisition of control over a Canadian business by non-Canadians. This can occur by either buying substantially all of the corporation’s assets or by purchasing its voting interest. The acquisition of control through voting interests occurs when a non-Canadian directly acquires more than 50 percent of the voting interest in a Canadian company, and is presumed to occur when there is an acquisition of at least 33 percent of the voting shares. At present, the threshold for acquisitions of control are based on book value, which is set at $344 million for 2013 and indexed annually to nominal GDP growth. A lower threshold of $5 million applies for investors who are not members in the World Trade Organization (WTO) or if the Canadian business is engaged in a cultural business.

 Accordingly, foreign investments that exceed the applicable monetary threshold must file an application for review with the Minister of Industry. In reviewing a transaction, the Minister of Industry has broad discretion to determine whether an investment is likely to be of ‘net benefit to Canada’. In doing so, the Minister considers the following factors: (a) the effect of the investment on the level and nature of economic activity in Canada, including the effect on employment, on resource processing, on the utilization of parts, components and services.

---

52 ICA supra note 50 at section 28(1).
55 It should be noted that as of July 2013, the Canadian Government passed Bill C-60, which includes proposed amendments to the Investment Canada Act (ICA) to implement the policy on investments in Canada by foreign state-owned enterprises (SOEs); the Bill introduces a new definition of “state-owned enterprise” in the ICA and provides for separate lower net benefit review thresholds that will be applicable to acquisitions of Canadian businesses by SOEs. Sandra Walker “SOE Amendments to “Investment Canada Act” passed (July 18th 2013) Toronto: Dentons. (http://www.dentons.com/en/insights/alerts/2013/july/18/soe-amendments-to-investment-canada-act-passed). Furthermore, the Government had confirmed that it would implement new thresholds for review of acquisitions of control by non-Canadians, other than SOEs, starting at $600 million and eventually increasing to $1 billion based on “enterprise value”; at the time of writing this paper, the Government has not indicated a precise date for issuance of the regulation implementing this 2009 amendment to the ICA.
56 Lawson A W Hunter, Ashley M. Weber and Marisa Berswick “A Guide to Navigating Canada’s Foreign Ownership Laws for New Investors” (January 2012) Toronto: Stikeman Elliott, Competition Law International. The Investment Review Division of Industry Canada, overseen by the Minister of Industry, is responsible for enforcing the provisions of the ICA. For foreign investments involving a ‘cultural business’, the Cultural Sector Investment Review Office of the Department of Canadian Heritage facilitates the review and the Minister of Canadian Heritage has ultimate authority under the ICA to review investments involving Canadian businesses engaged in specified cultural activities.
produced in Canada and on exports from Canada; (b) the degree and significance of participation by Canadians in the Canadian business and in the relevant industry; (c) the effect of the investment on productivity, industrial efficiency, technological development, product innovation and product variety in Canada; (d) the effect of the investment on competition within any industry in Canada; (e) the compatibility of the investment with national industrial, economic and cultural policies including relevant objectives enunciated by significantly affected provincial governments; and (f) the contribution of the investment to Canada’s ability to compete in world markets.  

In order to fulfill the requirements under the ‘net benefit test’, foreign investors commonly commit to certain undertakings for a period ranging from three to five years. Those undertakings typically relate to employment, Canadian participation in management, capital expenditure, place of head office and charitable contributions.  

2. Criticism to the Net Benefit Test

Much ink has been spilt during recent years over the ICA, specifically in relation to the appropriateness of the “net benefit test”. Following the rejection of BHP Billiton’s proposed acquisition of Potash Corporation of Saskatchewan in late 2010, the ICA has been frequently critiqued. Specifically, a report released by Canada’s Competition Policy Review Panel in 2008, entitled ‘Compete to Win’ noted, “While the Act contains criteria that the Minister is to consider when making the “net benefit” determination, these criteria are broad and afford the Minister substantial discretion in his decision making”. Similarly, the ‘net benefit test’ has been described as highly subjective, unpredictable and possibly detrimental to the economy’s long-term growth. It has also been criticized for lack of transparency, since the federal government does not give reason as to why a specific transaction failed the test.

Moreover, the recent bid made by CNOOC Ltd for Nexen Inc. in 2012 placed the federal government once again under scrutiny in relation to the test. The net benefit test was criticized

57 ICA, supra note 50 at Section 20.
58 Hunter, Weber and Berswick, supra note 56.
60 Bergevin and Schwanen, supra note 48.
again for its uncertainty and for the broad discretion granted to the Minister given the wide criteria for assessing the net benefit test; such discretion has been criticized for creating the risk of arbitrary or politically-motivated denials.\(^6^1\)

In sum, the subjective decision making process and broad discretion of the decision makers thus creates a suboptimal environment for foreign investors. Recent cases have highlighted the concern that Canada is becoming protectionist and that preference will be given to domestic investors amidst an increasing use of the political lens in the transaction screening process.\(^6^2\)

Under those circumstances, less focus will be given to foreign investments and their contribution to economic growth. Moreover, less attention has been given to the impact of protectionism on the evolvement of the corporate objective in Canada.

**B. Power of Corporate Directors**

In order to assess the possible role corporate directors in Canada may have in relation to hindering foreign investment, an overview of their fiduciary duties and powers is required so as to define the role with which they are entrusted.

Thus, this section focuses on the statutory fiduciary duties of board directors, as well as recent case law which have affected their mandate. In brief, this section provides that the broadened function of board directors and the deference they are granted by the courts entrust them with a public function and wide discretionary power to decide what the ‘best interest of the corporation’ is and a protection to act according to their judgment.

1. **Confirming Stakeholder Primacy as Law**
   a. **Corporate Directors Statutory Obligations**

The Canada Business Corporations Act (CBCA)\(^6^3\) imposes statutory fiduciary duties on directors of federally incorporated companies and they can be held liable for a breach of their fiduciary duties owed to the corporation. The first duty is codified in section 122(1)(a) of the CBCA, \(^6^1\)Grant Bishop, “Why Canada needs to take the politics out of foreign investment” The Globe and Mail (January. 14 2013) Available at: <http://www.theglobeandmail.com/report-on-business/economy/economy-lab/why-canada-needs-to-take-the-politics-out-of-foreign-investment/article7339244/> (Last accessed August 20th 2013)\(^6^2\)Norton Rose, supra note 53.\(^6^3\)Canada Business Corporations Act, R.S.C. 1985, c. C-4. [CBCA]
which states that directors of a corporation must “act honestly and in good faith with a view to
the best interests of the corporation” when exercising their powers and discharging their duties;
thus, the directors cannot place themselves in a position where their duty to act in the best
interests of the corporation conflicts with their personal interests. The second duty is to maintain
a standard of care when managing the corporation. The statutory standard for the amount of
care, diligence and skill required of corporate directors is set in section 122(1) (b) of the CBCA,
which requires directors to “exercise the care, diligence and skill that a reasonably prudent
person would exercise in comparable circumstances”.

In recent years, the question of ‘to whom the fiduciary duties are owed’ has taken its share of
debate in Canada, particularly after recent decisions made by the Supreme Court have
significantly impacted the Canadian corporate law. The first decision was in 2004, in Peoples v
Wise 64 when the Court rejected the argument that directors owe a fiduciary duty to creditors and
noted that:

[I]t is clear that the phrase the “best interests of the corporation” should be read not
simply as the “best interests of the shareholders”. From an economic perspective, the
“best interests of the corporation” means the maximization of 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 interests of the corporation. 65

The Court thus established that the directors may consider interests other than those of
shareholders when making a decision, including, inter alia, the interests of employees, suppliers,
creditors, consumers, governments and the environment. 66 The principle set in this decision was
later upheld in BCE v 1976 Debentureholders.
b. Fundamental Principals Governing Directors Duties

*BCE v 1976 Debentureholders*[^67] is a landmark decision by the Supreme Court of Canada which sets fundamental principles governing fiduciary duties. As opposed to *Peoples*, the Court examined their duties in the context of change of control.

BCE Inc. (BCE) is a Canadian telecommunications company, which wholly owns Bell Canada. Bell Canada had $7.2 billion in outstanding debentures issued pursuant to three trust indentures (1976, 1996 and 1997) at the time the proceeding took place. The debentures were held by financial institutions, pension funds and insurance companies. Following several expressions of interest in bidding for BCE, the board focused on starting an auction process where the change of control would result from a competitive process.

Hence, in April 2007, the bidders were provided with bidding rules and the general form of a definitive transaction agreement, in which they were advised to consider the impact of their financing arrangements on the debentureholders. The highest bid was made by a consortium led by Ontario Teachers’ Pension, presenting a 40% premium to the closing price of BCE shares, and was thus considered by BCE directors in the best interest of BCE and its shareholders. The transaction was to be affected by a plan of arrangement, which provided that Bell Canada would be required to guarantee approximately $30 billion of new debt. BCE’s shareholders approved the arrangement by a majority of 97.93 percent.^[68]

However, this resulted in the debentures being downgraded below investment grade, which in turn caused the debentures to decrease in value by an average of approximately 20%, thereby obliging debentureholders with credit-rating restrictions on their holding to sell their debentures at loss.^[69] The debentureholders thus opposed the court’s approval of the arrangement in the Quebec Superior Court claiming that the arrangement was oppressive as per s.241 of the CBCA and that it was not “fair and reasonable” as per the requirements of s. 192 of the CBCA.

At trial, the Quebec Superior Court dismissed the debentureholders’ claim and approved the transaction as fair and reasonable. The Quebec Court of Appeal then allowed the


[^69]: *Ibid* at para. 22.
debentureholders’ appeal, refusing to approve the transaction, on grounds that the transaction was not fair and reasonable. Finally, the Supreme Court of Canada (SCC) overturned the Court of Appeal decision and allowed the appeal holding that the Court of Appeal erred in concluding that the arrangement was not fair and reasonable nor was it oppressive to the debentureholders. In reaching its decision, the Supreme Court of Canada set the fundamental principles governing corporate fiduciary duties, as outlined below.

(1) The Best Interest of the Corporation

In reaching its decision, the SCC emphasized fundamental principles governing corporate directors’ statutory duties. The SCC reaffirmed the statement set in Peoples to the effect that directors owe their fiduciary duties to the corporation. In this case, the Court restated that the duties of the corporate board are owed to the corporation; the court noted:

[H]owever, the directors owe a fiduciary duty to the corporation, and only to the corporation. People sometimes speak in terms of directors owing a duty to both the corporation and to stakeholders. Usually this is harmless, since the reasonable expectations of the stakeholder in a particular outcome often coincide with what is in the best interests of the corporation. However, cases (such as these appeals) may arise where these interests do not coincide. In such cases, it is important to be clear that the directors owe their duty to the corporation, not to stakeholders, and that the reasonable expectation of stakeholders is simply that the directors act in the best interests of the corporation. 71

Revlon 72 was also explicitly rejected by the Court. In Revlon, where the issue in question was how directors should react to a hostile takeover bid, Delaware courts established that interests of shareholders should prevail over other stakeholders. The Court noted:

[W]hat is clear is that the Revlon line of cases has not displaced the fundamental rule that the duty of the directors cannot be confined to particular priority rules, but is

---

70 BCE, supra note 67 at para. 166-167.
71 BCE, supra note 67 at para. 66 [Emphasis added]
72 Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d. 173 (Del. 1986). In this case, the court decided that when the sale or break-up of the company is inevitable, the fiduciary obligation of the directors of a target corporation are limited to the maximization of stockholder value which requires the company to be auctioned or sold to the highest bidder.
rather a function of business judgment of what is in the best interests of the corporation, in the particular situation it faces. \(^{73}\)

(2) The Corporation as a ‘Good Corporate Citizen’

The Court recognized that there may be situations where corporate stakeholders may have conflicting interests, in which case, in resolving such conflict they are expected to act as a ‘good corporate citizen’.

[W]here the conflict involves the interests of the corporation, it falls to the directors of the corporation to resolve them in accordance with their fiduciary duty to act in the best interests of the corporation, viewed as a good corporate citizen. \(^{74}\)

(3) Corporate Duties ‘Broad and Contextual’

Furthermore, in *BCE*, the Court added that such duties may vary depending on each situation, noting that:

[T]he fiduciary duty of the directors to the corporation is a broad, contextual concept. It is not confined to short-term profit or share value. Where the corporation is an ongoing concern, it looks to the long-term interests of the corporation. The content of this duty varies with the situation at hand. \(^{75}\)

(4) Broad Range of Constituencies

More importantly, the SCC affirms *Peoples* noting that other corporate stakeholders may be considered to inform the decision of the board including inter alia, shareholders, employees, creditors, consumers, governments and the environment. \(^{76}\)

Furthermore, the Court asserted that, in reaching their decision, the court would accord deference to the board, as long as their decision was taking upon considering several reasonable alternatives, thus applying the BJR. \(^{77}\)

---

\(^{73}\) *BCE*, supra note 67 at para. 87.

\(^{74}\) *Ibid* at para 81 [Emphasis added]

\(^{75}\) *Ibid* at para 38.

\(^{76}\) *Ibid* at para 40.

\(^{77}\) *Ibid*. 

26
2. Deference to Directors’ Business Judgment

a. Following Due Process and Reasonableness

Canadian Courts have adopted a rule of deference to directors’ business decisions. Similar to the US, the BJR in Canada is an approach that respects the premise that directors and officers have business expertise that courts do not. The courts acknowledge that they are ‘ill-suited and should be reluctant to second guess the application of business expertise to the considerations that are involved in corporate decision making’.  Although the concept was adopted from U.S., it is now firmly established and has been applied by Canadian Courts. In Peoples Department Stores, the SCC endorsed the rule stating:

[d]irectors and officers often have business expertise that courts do not. Many decisions made in the course of business, although ultimately unsuccessful, are reasonable and defensible at the time they are made. Business decisions must sometimes be made, with high stakes and under considerable time pressure, in circumstances in which detailed information is not available. It might be tempting for some to see unsuccessful business decisions as unreasonable or imprudent in light of information that becomes available ex post facto. Because of this risk of hindsight bias, Canadian courts have developed a rule of deference to business decisions called the “business judgment rule”.

Peoples also adopted from Maple leaf that directors need only to make reasonable decisions chosen from reasonable alternatives;

The court looks to see that the directors made a reasonable decision not a perfect decision. Provided the decision taken is within a range of reasonableness, the court ought not to substitute its opinion for that of the board even though subsequent events may have cast doubt on the board’s determination. As long as the directors have selected one of several reasonable alternatives, deference is accorded to the board’s decision.

Furthermore, BCE makes clear that in exercising their business judgment, directors have to follow a proper process in the course of their decision making. To be sure, in order for the board’s decision to be respected in the context of a change of control, directors must act on an informed basis, in the best interests of the corporation; in doing so, they should consider the

---

78 Peoples, supra note 64 at para 67.
79 Ibid at para 64 [Emphasis added]
reasonable expectations of all stakeholders, not just shareholders. It was further confirmed that there is no strict Revlon duty to auction, as is the case in the US; however, the Board must consider all alternatives and may need to canvass the market in certain circumstances.

In responding to a bid, directors must act in good faith and take steps to minimize conflict of interest. If the Board follows a reasonable process which would also include the creation of a special committee with independent board members and the retention of outside financial and legal advisors, informed of all stakeholders’ rights and respect their legal rights, regardless if they decide to reject alternatives that would maximize shareholder value, BCE provides board with the protection of the BJR.

b. The BJR in a Takeover Context

In the context of assessing an unsolicited takeover bid or when considering defensive measures, in order to discharge the board from its fiduciary duties, the same due process as discussed earlier applies. Namely, the board of directors must act honestly and in good faith, with a view to the best interests of the corporation.

(1) Takeover Defenses and the BJR

In the late 1980s, Canada implemented the national securities regulatory policy on defensive tactics, which is currently National Policy 62-202 – Take-Over Bids – Defensive Tactics. Since then, the prevailing approach to shareholder rights plans (also known as ‘poison pills’) and other defensive tactics has been that they cannot be used to prevent shareholders from deciding for themselves whether to tender to a take-over bid. Accordingly, denying or limiting the ability of shareholders to make such decision is likely to result in action by securities regulatory authorities.

To be sure, the Canadian securities regulators regards a shareholder rights plan as a legitimate temporary measure that can be used solely to allow the target board a limited period of time to seek alternatives to a hostile bid. After a relatively limited timeframe, the applicable securities commission will, on application of a hostile bidder, cease trade the plan which may occur within

---

45 to 60 days. As a result, the board does not have the full discretion to “just say no” and the power to affect the change of control remains in the hands of shareholders rather than the board.

Having that said, in recent years, notably after the decision of the Supreme Court of Canada in *BCE*, the question raised was whether such approach taken by the securities regulators was contradictory to the one adopted by the Canadian courts which has asserted its willingness to defer to the business judgment of the board. This approach has been considered by security regulators in two cases – Pulse Data (Alberta Securities Commission, 2007) and Neo Materials (Ontario Securities Commission, 2009). In both cases, shareholders right plans receiving shareholders’ support were maintained.

To illustrate, the *Neo Material* case involved Pala who had announced its intention to make an unsolicited partial takeover bid for approximately 20% of the outstanding common shares, which if successful would have resulted in Pala increasing its position in Neo to approximately 40.5% of the outstanding common shares. Pala had structured the bid to comply with the “permitted bid” provisions in Neo’s existing shareholder rights plan by, among other things, remaining open for at least 60 days. Neo’s board of directors however adopted a second shareholder rights plan which, unlike the prior existing rights plan, excluded partial bids from “permitted bids”.

Following the launching of Pala partial bid, Neo held its annual and special meeting of shareholders at which its shareholders ratified the second rights plan by 81.24%, excluding Pala’s holdings. Pala subsequently applied to the Ontario Securities Commission (OSC) to cease trade the Neo shareholder rights plans. The OSC validated a target board’s decision to opt for the status quo and not to seek alternative offers at the time of the hostile bid. In coming to this conclusion, the OSC was both influenced by a shareholder vote to approve the rights plan and relied upon *BCE* regarding the BJR. The panel noted:

> [C]onsistent with the Supreme Court’s statements in *BCE* and the established body of corporate case law it is our view that, shareholder rights plans may be adopted for the

---

83 Re Pulse Data Inc., 2007 ABASC 895.
broader purpose of protecting the long-term interests of the shareholders, where, in the directors’ reasonable business judgment, the implementation of a rights plan would be in the best interests of the corporation. \(^{85}\)

Thus, the mentioned cases suggested that a target board can effectively ‘just say no’ to a hostile take-over bid provided that the target board exercises proper business judgment and can demonstrate shareholder support for a rights plan in the face of a bid. Nonetheless, more recent decisions \(^{86}\) have reflected a departure from the board centered approach in the mentioned cases.

(2) Recent Developments Related to Defensive Measures

Nevertheless, the Canadian Securities Administrators (CSA) has recently released the Proposed Rules for shareholder rights plans. \(^{87}\) The Proposed Rules put a great emphasis on the need to account for the board of directors’ fulfillment of their fiduciary duty when considering the reasonableness of a poison pill. Based on such premise, the CSA Proposed Rules suggest that the rights plan would remain in effect so long as it receives a majority vote of the target’s shareholders within 90 days following the board’s adoption or of the commencement of the bid and is voted on annually after that, unless waived or terminated by the target board or shareholders.

More importantly, CSA suggests that its intervention would decrease except in limited circumstances, thus claims would be diverted to courts. Thus, the Proposed Rules attempted to strike a balance between fiduciary duties and asserting shareholder primacy. On the one hand, the board would have sufficient time to consider alternative bids, if it finds that an alternative bid is in the best interest of the corporation consistent with BCE. On the other hand, shareholders would have the right to vote on the Plan, to approve it or to terminate it.

Such change in the regulations relating to defensive measures would undeniably increase the timeframe and expense for a hostile bidder. The Board would primarily benefit from the 90 days

\(^{85}\) Neo supra note 83 at para 112.

\(^{86}\) Lions Gate (BCSC, 2010), Baffinland (OSC, 2011), Mosaid (OSC, 2011), Afexa (ASC, 2011) and Inmet Mining (BCSC, 2012)

\(^{87}\) John Emanoilidis, Andrew Gray and Sophia Tolias “Canadian Companies Will Be Harder to Acquire Under New Poison Pill Proposals” (March 14th 2013), Toronto: Torys LLP.
before the Plan would be approved, after which, if approved, the pill may be in place indefinitely, subject to the shareholders’ annual vote. Accordingly, a bidder would attempt to terminate a Plan either through a shareholder vote, if the bidder can achieve the required support or through a proxy contest to replace the board, which is both a lengthy and expensive process.

Additionally, with claims being settled at court, the board would have further protection, particularly with the application of the BJR.

3. An Assessment of the Corporate Directors’ Power

The decision in *BCE* sets the main pillars of corporate fiduciary duties in Canada. To put them briefly, *BCE* sets that corporate directors should act in the best interest of the corporation; they should consider a wide range of corporate constituencies without giving precedence to one group over the other and should act as a good corporate citizen. Finally, *BCE* asserted that courts will respect the business decisions taken by directors provided that they follow and document a specific process and that they make a reasonable decision from reasonable alternatives.

The term ‘best interest of the corporation’ has been criticized for being uncertain; this was due to the fact that the Court enumerates the stakeholders to be considered without providing guidance as to how the balancing of interests would operate. It was also deemed indeterminate due to its reliance on a fictional being for whom the board would owe their duties to.

In addition to such ambiguities, fundamental weight should be given to *BCE* due to the fact that it emphasized that the Canadian corporate objective is not merely financial efficiency; instead board directors are mandated to focus on public policy concerns, thus granting them a function greater than the management of a private being. Moreover, given the procedural nature of the deference granted by courts to corporate directors, this deference protects their public function and strengthens their discretionary and broad role.

---

a. Setting a Broad and Discretionary Role for Board Directors

As has been noted, *BCE* makes clear that the board should be concerned with the best interest of the corporation. The decision establishes that increasing shareholder value is not the core duty of the board. Furthermore, it does not mandate value maximization when there’s an inevitable change of control. Quite the opposite, it places the burden on the board to be ‘a good corporate citizen’ and to consider interests varying from shareholders and creditors to employees, the community and the government.

The decision brings into question whether the SCC has unintentionally given the board broader power,\(^90\) particularly in a change of control context. Indeed, the debate caused by this decision over the scope of the fiduciary duties has truly framed the problem of identifying the corporate objective of Canadian corporations.

The decision thus dictates corporate directors to consider public policy concerns as well as community interest rather than focusing on business efficiency.\(^91\) Without the needed framework for balancing the interests, there remains the risk that directors arbitrarily use their duty to consider the public interest to justify their resistance to an acquisition or to protect their own interests at stake.

b. Redundant Procedural and Discretionary Barriers

Furthermore, the public function as yet attributed to corporate directors is strengthened by the BJR which shields directors’ decisions. Courts have repeatedly asserted their position in granting the stamp of approval for directors’ actions and decisions provided they follow reasonable process. That is to say, courts will defer to a board of directors’ decision to forego a transaction which would maximize shareholder value provided they meet the process required to discharge their fiduciary duties.

---

\(^{90}\) MacPherson, *supra* note 88 at 396.

Given the wide range of constituencies and interest boards should be concerned with and the power given to the boards through the BJR, such rule in fact provides a procedural tactic and a strong cover to the wide discretion conferred to the board.

C. Case Study: Exactly How Much Power Does the Board Have?

In this section, BHP Billiton’s bid for Potash Corporation (PotashCorp) is used to illustrate how state regulations and board powers come into play. It should be noted that, despite an agreement amongst commentators that the said bid for PotashCorp was rejected for political reasons, this transaction nevertheless is used to illustrate and compare the function granted by ICA to the Minister of Industry with that of corporate directors in the context of a change of control. Where a foreign acquiror is involved, this comparison begs the question of whether the powers entrusted to the board of directors are in fact sufficient to hinder a foreign acquisition and thus place an additional barrier for FDI.

1. Background of BHP Billiton’s Bid for PotashCorp

The parties involved in this case are the Canadian PotashCorp and the Australian BHP Billiton (BHP). PotashCorp is the world’s largest fertilizer enterprise, with common shares listed on the Toronto Stock Exchange and the New York Stock Exchange. BHP on the other hand is the world’s largest mining company and one of the largest companies in the world. It is a dual-listed company, comprised of two entities, one listed on the London Stock Exchange and the other listed on the Sydney Stock Exchange.

Following a meeting between the CEOs of BHP and PotashCorp on August 12th 2010, BHP delivered a letter to PotashCorp offering to purchase all of PotashCorp’s outstanding shares for an all cash purchase price of $130 per share in a negotiated transaction. BHP highlighted that the premium offered is in line with the average for acquisition transactions in Canada, representing 20% to PotashCorp NYSE closing price on August 11th 2010 and 35% of the

---

92 Potash Corporation “PotashCorp's Board of Directors Rejects BHP Billiton's Unsolicited, Non-Binding Proposal as Grossly Inadequate” (August 17th 2010) Available at: <http://www.potashcorp.com/media/POT_2010_Letter_from_BHP_Billiton's_Chairman.pdf> (Last visited July 17th 2013)
volume weighted average trading price of PotashCorp share on NYSE for the 30 trading days ended on that date. In addition to the offer made to the shareholders, BHP took into account other stakeholders in their offer. Particularly, BHP emphasized that their undertakings would include having the management team in Saskatchewan and other commitments relating to employment, capital programs and community programs and their commitment to “being a strong corporate citizen in Saskatchewan and Canada”.

2. PotashCorp’s Defensive Tactics

After discussing and evaluating the offer with PotashCorp’s legal and financial advisors, PotashCorp’s board of directors issued a press release disclosing the BHP offer and announcing that it was unanimously rejecting it. The board reasoned that BHP’s offer was timed to take advantage of depressed stock prices in the fertilizer industry, did not reflect the value of the company and as such was grossly inadequate. Accordingly, PotashCorp deemed it “not in the interest of the shareholder” to enter into discussion with BHP.\(^\text{93}\)

On the same day, PotashCorp announced that it had adopted a shareholders rights plan.\(^\text{94}\) The board had accordingly authorized the issuance of one share purchase right at a discounted price in respect of each outstanding common share of PotashCorp; this right would be exercisable if a person “acquires or announces an intention to acquire” beneficial ownership of shares which total 20% or more of PotashCorp outstanding shares. The plan excluded ‘permitted bids’ which are those made to all holders of shares, is open for a minimum of 90 days and is supported by a majority of PotashCorp’s shareholders. The press release ensured that the purpose of such plan was to provide the Board with sufficient time to “explore and develop alternatives to enhance shareholder value”.

Nevertheless, BHP formally commenced a tender offer for all of PotashCorp’s shares for a price of $130 per share on August 20, 2010. Following the announcement of the tender by BHP,

\(^{93}\) Potash Corporation “PotashCorp Board of Directors Rejects BHP Billiton’s Unsolicited Offer” (August 23rd 2010) Available at: (http://www.potashcorp.com/media/POT_PotashCorp_Rejects_BHP_Billitons_Unsolicited_Offer.pdf) (Last visited on July 17\(^{th}\) 2013)

PotashCorp urged its shareholders to reject the offer and not to tender their shares for the same reasons.\(^95\) In October, BHP objected to the rights plan, arguing that the conditions of a permitted bid had been met and that no alternative bids had emerged; the Saskatchewan Financial Securities Commission scheduled a hearing for November 8 to determine whether to “cease trade” the plan.\(^96\)

3. ICA: Is the Deal in the Net Benefit of Canada?

In the meantime, while PotashCorp’s board was using their arsenal of defensive measures to fend off the BHP bid, the deal had shifted into a matter of public concern. Following Premier Brad Wall’s statement (leading the provincial government of Saskatchewan) that PotashCorp was a “strategic asset” which should not rest entirely outside of Canada, the Canadian media centered on the loss of ‘strategic resource’ to foreign investor, thereby generating a divided public opinion about the matter of foreign investments.\(^97\) Eventually, the federal government rejected BHP Billiton's $40-billion takeover bid for PotashCorp announcing that it was not likely to be of net benefit to Canada under the ICA.\(^98\)

The deal fell short from being in the net benefit of Canada in spite of an expensive list of undertakings totaling more than $1 billion which was detailed in a press release by BHP following the failure of the bid. Among others, the undertakings included a five-year commitment to remain in a Canadian potash export group, significant spending on infrastructure, increased investment in BHP’s already planned Jansen mine located in Saskatchewan, commitments to forgo certain tax benefits to which they were legally entitled to and to apply for a listing on the Toronto Stock Exchange, employment increases, spending on community and education programs, and an unprecedented US$250 million performance bond to ensure the company fulfilled its undertakings.\(^99\)

\(^{95}\) PotashCorp, supra note 93.

\(^{96}\) Bruce Johnstone, “BHP to argue against PotashCorp Poison Pill In November 8 Gearing” Financial Post (October 25th 2010) http://www.financialpost.com/argue+against+Potash+Corp+poison+pill+hearing/3724251/story.html (Last visited August 11, 2013)

\(^{97}\) Norton Rose, supra note 53.


\(^{99}\) BHP Billiton, ‘BHP Billiton Withdraws Its Offer to Acquire PotashCorp and Reactivates its Buy-back Program’ Press Release (15 November 2010). Available at
4. Empowering Corporate Directors with a Bigger Arsenal

Despite consensus that the rejection of BHP was motivated by political considerations, especially with elections taking place later that year, the question raised here, given recent case law, is whether PotashCorp’s board was already sufficiently empowered to thwart off the bid. They had indeed managed to block the bid by using their duties and powers to hinder BHP from succeeding in its bid.

PotashCorp’s takeover failure underlined the nationalist inclination in the Canadian public opinion and the fear of losing what was referred to as “strategic assets”. This failed transaction paved the way for additional tools to be added to the defensive tactics used by boards to push away unwanted bid, particularly foreign ones.

With a similar protectionist approach, the echoing of policy concerns was later used by boards to fend off unwanted bids. This scenario repeated itself in Lowe’s - a U.S. home improvement retailer- takeover bid for Rona, the largest Canadian distributor and retailer of hardware, home renovation and gardening products. In this case, Rona had received a proposal from Lowe’s to acquire all of Rona’s issued and outstanding shares at a price of $14.50 per share in early July 2012. Rona’s board of directors and a special committee of independent directors, with the assistance of their financial and legal advisors, commenced a review and evaluation of Lowe’s non-binding proposal. Almost three weeks later, Rona informed Lowe’s that its board of directors had unanimously determined that Lowe’s proposal is not in the best interests of Rona and its stakeholders\(^\text{100}\) and the offer was never taken to the shareholders.

In this case though, the shareholders had voiced discontent from the management’s performance. Investco, which holds 12% stake in Rona, had in fact confirmed supporting the $1.76-billion bid by Lowe’s. Yet, the matter had escalated once again into a matter of public opinion and again,

Rona was dubbed a ‘strategic asset’. In fact, commentators agree that the Board’s delay to disclose the offer was intentional, knowing that soon elections would be held in Quebec.  

D. An Analogy between ICA and BCE

1. Corporate Directors’ Function Echoing State’s Protectionist Policy

To reiterate, Rickford suggested that there are two forms of protectionism in company law, either by government to protect the local market under the veil of social policy or through private powers to protect their interest using corporate interest as a justification. The analogy made between the ICA and the corporate directors’ function illustrated how the state and the private powers each play their respective roles in economic protectionism, both using the public interest as a justification to the discretionary powers.

The assessment of the ICA concluded that the Act gave broad discretion to the Minister of Industry and has been blamed for reflecting the protectionist stance taken by Canada. Subsequently, an assessment was made of corporate directors’ powers in Canadian corporations, highlighting their broadened public functions and the discretion conferred to them by courts, thus adding to the barriers to foreign investment. As illustrated in the PotashCorp bid, the private powers may now make use of the public function granted to them by BCE as an additional defensive tactic against unsolicited bids; such broad function thus allows them to protect the corporation from being acquired or to protect other interests at stake including their own.

In practice, upon making a takeover bid, a foreign acquiror should pay a great deal of attention to the wide range of constituencies and interests of main concern to the Ministry of Industry – where applicable- and the board of directors. As examined, in order to satisfy the net benefit test, foreign investors are required to provide undertakings targeted at the social, economic and political interest of Canada. The broadness of the list enumerated in section 20 of the ICA, which provides guidance to the Minister of Industry, allows the government to reject a foreign investor by giving priority to public interest, which has an appeal to the public. Equally, upon making a

---


102 Jonathan Rickford, ‘Protectionism, Capital Freedom and the Internal Market’ in Bernitz and Ringe, Supra note 8 pp 54.
business decision, corporate directors should consider the wide range of constituencies including employees, contractors and the community. This is broad enough to allow directors to justify their actions and decisions with the broader public interest at stake.

In the context of Lowe’s bid for Rona, Teamster, a major union joined the opposition against the bid for Rona, expressing concern about ‘the survival of jobs’ if the deal succeeds. The bid was also opposed by Rona’s franchisees who made it clear that their choice to adhere to Rona was based on their trust in Canadian local suppliers, who have local community at its core. Following Lowe’s Cos. Inc.’s withdrawal from its bid for Rona Inc. amid disapproval by Rona’s board and opposition from the Quebec government, it has been said that the fact that foreign companies need to satisfy shareholders, the provincial government, opposition parties and provinces will have a ‘chilling effect’ on foreign investments.

2. Discretionary and Undue Application of the Public Interest Rationalization

Much attention has been given to the PotashCorp deal and how it highlighted the political angle in the application of the ICA. Nonetheless, the deal was interesting from yet another angle: not only did it provide grounds to believe that boards of directors are sufficiently equipped to block unwanted foreign bids, it also reflected the redundancy of ‘public interest’ requirements under the ICA and the stakeholders’ approach confirmed by BCE and how it was used to reject a foreign bidder.

In this paper, BHP’s bid was presented to demonstrate that PotashCorp had already adequately positioned itself to reject the bid. Aside from the political outcome, in terms of authority to reject an unsolicited foreign acquiror, the broadness of the corporate objective in addition to the arsenal of defensive measures and authorities granted to the boards of directors, as elaborated in this


105 Eric Lam and Frederic Tomesco “Rona/Lowe’s fallout may have ‘chilling effect’ Provincial government intervention seen as threatening future foreign investment” Montreal Gazette (September 20th 2012) Available at: <http://www.montrealgazette.com/business/Rona/Lowe+fallout+have+chilling+effect/7271679/story.html> (last accessed July 22nd 2013)
paper, ultimately places the board at par with the discretionary power of the government. Moreover, this power would be further heightened in the event the newly Proposed Rules by CSA are approved; in such case, the boards of directors will wider latitude to resist an unsolicited bid.

The assessment made in this paper demonstrates how corporate directors’ duties have evolved to reflect the state’s policy towards the use of the public interest as a barrier to foreign investment. At present, both the government as well as boards has the power to justify their actions with the same rationale, setting a broad range of requirements to be met. With this in mind, foreign investors are left at the mercy of the broad discretionary state regulations as well as the authorities granted to the corporate board, creating a less than desirable investment environment in Canada.

Assuming that the corporate directors have a public function which echoes the state regulations governing foreign investments, an additional question raised here is whether the public interest function affects the investors’ interest once they have entered the market.

E. Ramifications of the Public Interest Function and Investors’ Undertakings

As has been previously noted, BCE has affected the framework of Canadian corporate directors’ duties. In short, directors of Canadian boards at present have a broad public function rather than a limited obligation to run financially efficient corporations. That said, foreign investors should consider the financial and strategic implications of the board’s duties once they are accepted in the Canadian market. Indeed, their representatives on the board would remain committed and accountable to their undertakings and duties.

1. Impact on Financial Interest

Recent cases have demonstrated that the performance of undertakings made by foreign investors would be monitored and legal action would be taken against unsatisfactory compliance. A prominent example is the proceedings commenced by the Canadian Minister of Industry against the US Steel Corporation pursuant to ICA, seeking an order directing compliance and a penalty for non-compliance.
The case involves the Canadian steel company Stelco, which had been going through economic turmoil for several years. Since the beginning of 2002, the company had repeatedly reported losses blaming it on high energy prices, competition from low-priced imports and reduced demand taking place several months after the September 11th terrorist attacks. Stelco sold several assets, job cuts were made and the company suffered a $1.3 billion deficit in pension funding obligations.

In 2004, Stelco obtained bankruptcy-court protection under the Companies’ Creditors Arrangement Act. Outraged by this decision, Stelco’s union leaders launched an unsuccessful battle which was overturned by the Ontario Court of Appeal and the Supreme Court of Canada. Consequently, the company put itself up for sale then later abandoned the idea and opted for the restructuring option. Stelco then received a contribution of $100 million for Stelco’s employee by the Ontario government as well as further funding in 2005 for the restructuring plan by both the federal and Ontario governments. The company emerged from bankruptcy protection in 2006 and with an increase of consolidation in the steel sector, it once again offered itself for sale.\(^\text{106}\)

In September 2007, U.S. Steel Corporation agreed to buy Stelco for US$1.9 billion,\(^\text{107}\) and submitted the required application for ministerial review and approval under the ICA. The Minister approved the transaction deeming it likely to be for the ‘net benefit’ of Canada, subject to thirty one binding undertakings which U.S. Steel agreed to abide by as part of its obligations under the Act.

However in 2009, following the global economic crisis, US Steel announced the closure of two mills and lay-offs of 1,500 employees. Consequently, the Minister of Industry notified U.S. Steel that it had not complied with two of the undertakings, specifically the obligation to ensure steady employment levels and continued production at the two plants. In response to the allegations,


U.S. Steel had stated that its non-compliance was due to factors beyond its control, including the impact of the global economic crisis on the steel industry.

Following a long court case filed by Canada against US Steel, the parties reached a final settlement during 2011 which included additional undertakings on those made by US Steel at the time of the acquisition. The additional undertakings included substantial capital investments and financial contributions to local communities.\(^\text{108}\)

The question raised here may be complex: Given the economic fragility of Stelco at the time of its acquisition and the subsequent global economic crisis, had a claim been filed by the union against US Steel for the job cuts, would the court defer to the business judgment of the board given the circumstances during which their decision was made? Would a similar decision by the board of the newly acquired company be deemed in the best interest of the corporation had it not been owned by a foreign investor?

Recent case law, as elaborated earlier in the present paper, would suggest that provided that the board had followed reasonable process, the court would defer to the business judgment of the board. More importantly, similar board decisions had indeed been taken by Stelco and were deferred to by Canadian courts, as previously mentioned. With that in mind, it appears that the public interest function which mandates directors to serve the best interest of the corporation cannot by the same token be used by foreign shareholders given their submission to the requirements of ICA. Accordingly, despite the sizeable investment made, foreign investors are placed in a position that undermines their ability to sustain the economic viability of their investment as well as their ability to affect necessary decisions in the interest of the corporation.

Similarly, in strategic industries, a minimum number of Canadian directors are required to be present on the board. In the same manner, the question of whether foreign shareholders are indeed empowered to affect financial and strategic decisions of the corporation is again posed in this context.

2. Impact on Strategic Interest

Foreign investors may be required to commit to a specific number of Canadian resident board members within their undertakings in order to satisfy the requirements under the ICA. Yet even in circumstances where the ICA does not apply, foreign investors may have limited representation on the board of directors.

As a general rule under the CBCA, at least twenty-five per cent of the directors of a corporation must be resident Canadians. However, in the CBCA section 105(3.1), an exception is made for particular business sectors where a corporation is required ‘to attain or maintain a specified level of Canadian ownership or control, or to restrict, or to comply with a restriction in relation to, the number of voting shares that any one shareholder may hold, own or control’; in such case, a majority of the directors of the corporation must be resident Canadians.

Initially, the residency requirement was adopted in the 1970s with the intent to ensure that the Canadian view would be expressed in directors’ meetings of corporations controlled by non-resident Canadians. Furthermore, it was adopted to ensure that local directors are available to account for any outstanding liabilities and to protect Canadian subsidiaries of foreign corporations from being subject to extraterritorial application of foreign laws.

In a discussion paper issued by Industry Canada in 1995, it highlighted that such requirement could be avoided either by incorporating in a province which does not set the director residency requirement. Alternatively, it could also be avoided by the execution of shareholder agreements, whereby shareholders can transfer to themselves the directors’ duties to manage and supervise the management of the corporation. Given recent development of corporate board duties and particularly the duties set by BCE, it is unlikely that the court would relieve directors from their liability notwithstanding the execution of a shareholders agreement. Otherwise, it proposed that

---

109 Section 2(1) of the CBCA defines a resident Canadian as an individual who is (a) a Canadian citizen ordinarily resident in Canada; (b) a Canadian citizen not ordinarily resident in Canada who is a member of a prescribed class of person; or (c) a permanent resident within the meaning of the Immigration Act and ordinarily resident in Canada, except a permanent resident who has been ordinarily resident in Canada for more than one year after the time at which he first became eligible to apply for Canadian citizenship.


111 Industry Canada, Supra note 110 at pp15-16.
shareholders would appoint directors who have a ‘vested interest in reflecting the objectives of the parent corporation’ such as lawyers or accountants.

However, the paper elucidates that such requirement, among other things, limits the flexibility of corporations and limits the shareholders’ ability to put on the board the best qualified people. Furthermore, limiting the number of required resident Canadian would allow Canadian export-oriented corporations to develop foreign markets by adding foreign directors to attract investors, partners, strategic alliances and access to global markets; foreign directors in multinational corporations would also reflect the international nature of their markets and operations.\(^\text{112}\)

As previously noted, the required number of resident Canadian board representatives is increased in strategic industries. In addition to the pre-entry process set by the ICA, foreign investors are subject to additional restrictions on ownership and control in certain industries in Canada. Put differently, even if a transaction is not subject to the ICA, it may still be subject to the restrictions set for foreign ownership. This is becoming increasingly important because most of relevant industries are those that foreign investors target the most.

Generally, the Canadian ownership and control rules establish formal limits on measurable factors, such as the percentage of voting shares that non-Canadians can hold or the percentage of the board of directors that must be Canadian. To illustrate, the Telecommunications Act\(^\text{113}\) states that a telecommunications company that owns transmission facilities such as a cellular telephone company, will only be eligible to operate in Canada if it is Canadian owned and controlled. In order to meet that requirement at least 80% of its directors must be Canadian, Canadians should own at least 80% of its voting shares, and it should be controlled-in-fact by Canadians. Hence, a

\(^{112}\) Industry Canada, supra note 110 at 21-22.
\(^{113}\) Telecommunications Act, SC 1993 at Section 16
“Canadian” company is one where Canadians own at least 66.7% of its voting shares, and is controlled-in-fact by Canadians. In addition to the telecom sector, other industry-specific ownership restrictions exist in several other sectors in Canada, including book publishing and selling, collection agencies, engineering, farming, fisheries, liquor sales, mining, oil and gas, optometry, pharmacies and securities dealers. Similar to the telecommunication industry, corporations working in broadcasting would be required that (a) at least 80% of its directors be Canadian, (b) Canadians must own at least 80% of its voting shares, and (c) the CEO must be Canadian. In other sectors where the percentage of required Canadian directors is not expressly stated, the general rule is that the majority of the directors should be Canadians.

Those restrictions proved to be problematic when Globalive made a bid for the new spectrum licenses for advanced wireless in 2007. Globalive was funded by a transnational Egyptian-controlled company, namely Orascom Telecom Holding SAE (Orascom), which was challenging given the requirements of the Canadian ownership and control requirements (COC) under the Telecommunications Act, as has been previously noted. After various levels of investigation, Globalive was ultimately allowed to begin operating its ‘Wind Mobile’ wireless phone service in Canada. Globalive entry to the market was accredited to the design of its ownership structure to

---

114 Lorne P. Salzman “Canada’s Ownership and Control Rules: What Every Eager Foreign Investor Should Know” (April 15th 2009) Toronto: McCarthy Tetrault Publication. Available at: http://www.mccarthy.ca/article_detail.aspx?id=4467 (Last accessed August 4, 2013). The explanation given in 1993 by the National Transportation Agency when it assessed the investment by the parent of American Airlines in Canadian Airlines, provides guidance with regards to the term ‘control-in-fact’: ‘There is no one standard definition of control in fact but generally, it can be viewed as the ongoing power or ability, whether exercised or not, to determine or decide the strategic decision-making activities of an enterprise. It also can be viewed as the ability to manage and run the day-to-day operations of an enterprise. Minority shareholders and their designated directors normally have the ability to influence a company as do others such as bankers and employees. The influence, which can be exercised either positively or negatively by way of veto rights, needs to be dominant or determining, however, for it to translate into control in fact.’

115 It should be noted that in June 2012, foreign investment restrictions in the Telecommunications Act have been amended in order to allow non-Canadian investors to control 100% of domestic wireless firms that have a market share of 10 per-cent or less. Roger Watkiss ‘Foreign Ownership Restrictions Relaxed for Telecom Carriers in Canada’ (2012) Norton Rose Publication. Available at: http://www.nortonrosefulbright.com/knowledge/publications/68939/foreign-ownership-restrictions-relaxed-for-telecom-carriers-in-canada> (Last accessed August 4, 2013)

116 Hunter, Weber and Berswick, supra note 56.

satisfy the COC requirements; it was structured in a manner to limit its ownership to less than one-third of the voting shares of the Canadian business, and increasing the number of Canadian directors on the board of the Canadian business.118 Later in 2011, the founder of Orascom Telecom expressed reluctance to expand their business in Canada due to the inefficient ownership structure where the Canadian equity owners have control over the company, even though Orascom put up more than 80 per cent of the funding.119

IV. Concluding Notes

In an interview with Naguib Sawiras, the Egyptian behind the financing of Canadian Wind Mobile cellular telephone company, he expressed his regret for entering into the Canadian market stating "There's no real political will here to introduce competition into this closed market". Moreover, Sawiras insisted that the Canadian market protects its players, questioning whether they would have otherwise had their place in the global market.120

This paper argues that economic protectionism may take nontraditional forms. In the context of FDI, additional subtle barriers are entrusted to private powers to protect the internal market from foreign competition. This protectionist stance is usually a reaction to the public’s fear of foreign control over the national economy and strategic industries. Hence, only can markets truly be open for competition if there is real political will to affect such change as well as an effort to transition the public’s mindset towards the acceptance of FDI.

The argument placed here is that the design of company law may empower private bodies with functions originally entrusted to the state. Indeed, it has been said that company law may be used either by states as a barrier to foreign investments, rationalizing their actions as a social policy; alternatively, the tools available in company law may be used by those who control corporations to protect themselves from a foreign acquisition, justifying their actions by the corporate interest.

Canada provides an accurate illustration where state regulations and company law place layers of barriers for foreign investors to enter and maintain their interests in the market. Canada has

118 Hunter, Weber and Berswick, supra note 56.
120 Ibid.
abundant natural resource wealth; it is one of the largest producers of uranium and potash, natural gas and the largest supplier of crude oil, petroleum products and natural gas to the US.\textsuperscript{121} However, natural resources are expensive to develop and Canada requires $650 billion to fully exploit and extract its oil reserves alone.\textsuperscript{122}

In recent years, the question of whether Canada is open to foreign investments was put to the test. Particularly, there has been an ongoing debate on the ‘net benefit test’, which requires any foreign acquiror of a Canadian corporation to prove that such acquisition would be in the net benefit of Canada. Recent transactions have proven that the broadness of the test grants the Minister of Industry broad discretionary power to use the Act as and when it is deemed politically feasible.

Similarly, in the context of empowerment through private law, the corporate fiduciary duties in Canada have evolved to reflect a similar public interest function as in the ICA. Corporate directors have a mandate to consider different stakeholders of the corporation upon making any decision; this includes employees, contractors, the government and the community. In practice, this broad public function with which boards have been entrusted risks to be used arbitrarily as an additional defensive tactic against unsolicited bids; yet, while the mandate is meant to protect the best interest of the corporation, boards may use such mandate to resist the acquisition of the corporation or may also use it to protect their own interests at stake.

It has been argued that the \textit{BCE} has unintentionally expanded the power of board directors and it has indeed. \textit{BCE’s} decision requires board directors to consider public policy concerns in their decision making processed; it has thus entrusted board directors with a public function which in principal is a state function. \textit{BCE} provides that the corporate objective for Canadian corporation is centered on public interest and should not give precedence to economic efficiency of corporations. From a foreign investors’ lens, it may be difficult to align their investment strategies with the Canadian corporate objective. Ultimately, this may prove to be detrimental to the public interest on the long run.

\textsuperscript{121} Compete to win, \textit{supra} note 59.
\textsuperscript{122} Jean Chua “Why the Nexen-CNOOC Deal Will Spur more Energy Deals” CNBC (December 9th 2012). Available at http://www.cnbc.com/id/100293769 (Last accessed August 20, 2013)
The challenge in the criteria set in the ICA’s ‘net benefit test’ as well as the corporate objective which requires directors ‘to act in the best interest of the corporation’ is that they do not give tangible objectives and that they both assess the transaction in the context in which it has been made. Yet, the question is whether the economic viability of a state or a corporation should rely on short term undertakings and considerations or rather ensure its long term economic sustainability.

In the context of FDI, especially given the state’s role, it is essential to question whether there’s a need to expand the board’s duties to cover the said public function. The public and its interests are constantly evolving in terms of nature and needs; to require directors to react to the constant change of public policy diverts directors’ attention from the core function of a corporation, which is being an efficient constituent of the economy.

Last but not least, to consider that the best interest of a corporation is anything but its economic viability would have a negative impact on the long term growth of the Canadian market. Thus, the redundancy and ambiguity of the public function mandate creates unnecessary barriers for market openness, competition and presence in the global market.
Bibliography

Legislation

Canada Business Corporations Act, R.S.C. 1985, c. C-4. [CBCA]


Telecommunications Act, SC 1993


Case Law

Unocal v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985)


Peoples Department Stores Inc. (Trustee) v. Wise, [2004] 3 S.C.R. 461 (Can.)

Pulse Data Inc., Re, 2007 ABASC 895


Secondary Material: Books, Reports and Commentaries

Andrew Keay, The Enlightened Shareholder Value Principle and Corporate Governance (Abingdon: Routledge, 2013)


John Emanoilidis, Andrew Gray and Sophia Tolias “Canadian Companies Will Be Harder to Acquire Under New Poison Pill Proposals” (March 14th 2013), Toronto: Torys LLP.


OECD “Foreign Direct Investment for Development – Maximizing Benefits Minimizing Cost” (2002). Paris: OECD. Available at:


P.M. Vasudev and Susan Watson, Corporate Governance After the Financial Crisis (Cheltenham: Edward Elgar Publishing Limited, 2012)


Secondary Material: Web Resources


Bruce Johnstone, “BHP to argue against PotashCorp Poison Pill In November 8 Gearing” Financial Post (October 25th 2010)
http://www.financialpost.com/argue-against+Potash+Corp+poison+pill+hearing/3724251/story.html


Eric Lam and Frederic Tomesco “Rona/Lowe’s fallout may have ‘chilling effect’ Provincial government intervention seen as threatening future foreign investment” Montreal Gazette (September 20th 2012) Available at: <http://www.montrealgazette.com/business/Rona/Lowe+fallout+have+chilling+effect/7271679/story.html>


Jean Chua “Why the Nexen-CNOOC Deal Will Spur more Energy Deals” CNBC (December 9th 2012). Available at <http://www.cnbc.com/id/100293769>

John Authers, “Short View: Defining Protectionism” (February 2nd 2009); Financial Times Available at: <http://www.ft.com/intl/cms/s/0/c70dade6-f157-11dd-87900000779fd2ac.html#axzz2VvZsa1O1>

Potash Corporation “PotashCorp's Board of Directors Rejects BHP Billiton's Unsolicited, Non-Binding Proposal as Grossly Inadequate” (August 17th 2010) Available at: <http://www.potashcorp.com/media/POT_2010_Letter_from_BHP_Billiton's_Chairman.pdf>

Potash Corporation “PotashCorp Board of Directors Rejects BHP Billiton’s Unsolicited Offer” (August 23rd 2010) Available at: (http://www.potashcorp.com/media/POT_PotashCorp_Rejects_BHP_Billitons_Unsolicited_Offer.pdf)


