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THE BCE BLUNDER: AN ARGUMENT IN FAVOUR OF SHAREHOLDER WEALTH MAXIMIZATION IN THE CHANGE OF CONTROL CONTEXT

Patrick Lupa*

INTRODUCTION

The job of a corporate director has become increasingly complex - gone are the days where board members were essentially “rubber stamps” to management initiatives.¹ Currently, the board of directors is the highest governing authority within the management structure of any company. Some responsibilities of boards include selecting, evaluating, and approving compensation for the company’s chief executive officer, approving the company’s financial statements and paying dividends. One of the most difficult decisions that a director may face has to do with recommendations on change of control transactions.

Changes of control include transactions where shareholders lose control of the corporation or where the corporation ceases to exist.² This type of transaction represents a significant event in the existence of any company. The most common change of control transaction is the sale of a corporation. It is the responsibility of the board to recommend whether or not shareholders should approve any change of control.

When making determinations with regard to changes in control, directors are guided by their fiduciary duty. This duty requires them to act in “the best interests of the corporation”. Unfortunately, understanding what acting in “the best interests of the corporation” entails may be a more difficult task than determining whether or not to recommend the sale of a company.

One of the main issues with the “best interests of the corporation” standard is that corporations are made up of multiple interests with independent goals and welfare concerns. For example, during a change of control transaction, shareholders will seek to

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¹ James Westphal & Edward Zajac, “Defections from the Inner Circle: Social Exchange, Reciprocity, and the Diffusion of Board Independence in U.S. Corporations” (1997) *Admin Sci Q*, Vol 42.

² Mohammad Fadel, “BCE and the Long Shadow of American Corporate Law” (2009) 48 *CBLJ* 190 at 201 [*Fadel*].

maximize the value of their shares, employees will seek job security, and creditors will want to ensure that their loans continue to be repaid. Given these largely conflicting goals, it is almost impossible for a director to please all interested parties.

Two theoretical models provide guidance to directors as to what “the best interests of the corporation” standard requires: shareholder primacy and stakeholder theory.³ Generally, shareholder primacy necessitates that directors maximize shareholder value when making decisions. Although directors may consider the interests of other stakeholders, they are unable to act in a way that has a negative impact on shareholders.

Conversely, stakeholder theory contemplates a broader social role for corporations. Stakeholder theorists argue that unilateral focus on shareholder wealth fails to recognize that groups outside of shareholders are integral to the success of the corporation. According to stakeholder theory, directors’ fiduciary duties should require them to contemplate a broader range of interests than just shareholders.

The Supreme Court of Canada recently weighed in on the debate in the cases of *Peoples v Wise*⁴ and *BCE v 1976 Debentureholders*⁵. These decisions stand for the proposition that directors’ fiduciary duties permit them to consider the interests of a wide variety of stakeholders when making a determination. In the change of control context, directors are free to consider the interests of all corporate constituents prior to recommending whether or not shareholders should approve a given transaction.

This paper will explore some of the issues that *Peoples* and *BCE* raise. It will be argued that directors’ duties should require them to focus exclusively on increasing shareholder value in the change of control context. Although ensuring that stakeholder interests are not disregarded is an important goal, mechanisms such as contracting, legislation and the political process provide an effective regime for protecting stakeholders. In contrast, shareholders’ status as residual claimants necessitates that they be protected by an exclusive fiduciary duty.

The paper will be broken into three sections. Section I will examine the case law and legislation, which detail the content of fiduciary duties in Canada. Section II will critique the fiduciary duties outlined by the Supreme Court in *Peoples* and *BCE*. Section III will outline a variety of arguments as to why directors’ fiduciary duties should require them to focus exclusively on maximizing shareholder value in the change of control context.

³ More recently other theories have emerged including team production theory and director primacy. For a discussion on each see Margret Blair & Lynn Stout “A Team Production Theory of Corporate Law” (1999) 85 Vir LR 247 and Stephen Bainbridge “Director Primacy: The Means and Ends of Corporate Governance” (2003) 97 Nw ULR 548 [*Bainbridge*].

⁴ *Peoples v Wise*, 2004 SCC 68 [*Peoples*].

⁵ 2008 SCC 68 [*BCE*].

I. DIRECTORS' FIDUCIARY DUTIES: WHO'S BEST INTERESTS?

Although traditionally a common law duty, Canadian directors' fiduciary duties are currently set out in section 122 of the *Canada Business Corporations Act*.⁶ The section provides that "every director and officer of a corporation in exercising their powers and discharging their duties shall act honestly and in good faith with a view to the best interests of the corporation."⁷ Generally, the purpose of imposing fiduciary duties on directors is to ensure that they carry out their responsibilities with the utmost good faith, that they do not act in their own interests and that they are loyal to the corporation when executing their roles and responsibilities.⁸

This section of the paper will trace how courts have interpreted the "best interests of the corporation" standard. Part A examines some early decisions which seemingly set a strict shareholder primacy approach requiring directors to focus their decision-making power exclusively on maximizing shareholder value. This part also outlines some other corporate law principles that have diluted the strict shareholder primacy approach. Part B examines how courts have interpreted the "best interests of the corporation" standard in the change of control context. Finally, Part C examines the approach to fiduciary duties outlined by the Supreme Court in *BCE*.

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

The current directors' fiduciary duty traces back to a comprehensive report examining corporate law in Canada by the Dickerson Committee.⁹ By suggesting such a wide provision, the Dickerson Committee implicitly contemplated the involvement of courts in fleshing out the content of directors' fiduciary duties.¹⁰ However, the courts were not left without any guidance. At the time the *CBCA* was amended, there existed a substantial body of common law that addressed the meaning of the "best interests of the corporation."

Some early articulations of directors' fiduciary duties equated the "best interests of the corporation" with the best interests of shareholders. This view was largely grounded in the notion that shareholders owned the corporation due to their capital contribution.¹¹

⁶ [1985] c 44 [*CBCA*]. Canadian provincial corporate law statutes vary slightly with regard to directors' fiduciary duties. This paper will focus on the duty found in s 122 of the *CBCA*.

⁷ *CBCA*, *supra* note 6.

⁸ Harris et al., *Cases, Materials and Notes on Partnerships and Canadian Business Corporations*, 4th ed (Toronto: Thomson Carswell, 2004).

⁹ Robert Dickerson et al, *Proposals for a New Business Corporations Law for Canada*, vol 1 (Ottawa: Information Canada, 1971).

¹⁰ See Mohamed Khimji, "Peoples v. Wise – Conflating Directors Duties, Oppression, and Stakeholder Protection" (2006) 39 *UBC L Rev* 209 at 212 [*Khimji*]. (Khimji also suggests that the duty was set up in such a way as to accommodate "evolutions in the law to reflect shifts in attitudes and values" at 212).

¹¹ Milton Freedman, "The Social Responsibility of Business Is to Increase Its Profits" *The New York Times Magazine* (September 13, 1970).

One of the first cases to articulate the position was *Hutton v West Cork Railway Company*.¹² In the seminal judgment, Bowen J. pronounced: “the law does not say that there are no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company,” and the company means the shareholders.¹³

This shareholder-focused view of the corporation was adopted less than 40 years later in the infamous *Dodge v Ford Motor Co* case.¹⁴ In *Dodge*, shareholders’ complained directors had breached their fiduciary duty when they decided to allocate corporate profits to lowering the cost of cars and increasing employment opportunities within the community rather than paying out dividends. Examining the obligation of directors, the court noted that:

A business corporation is organized and carried on primarily for the profit of stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end and does not extend to a change in the end itself, to the reduction of profits or the non-distribution of profits among stockholders in order to devote them to other purposes.¹⁵

The court in *Dodge* envisioned a strict requirement that directors focus solely on maximizing shareholder value.¹⁶ However, the decision is somewhat of an outlier and the shareholder primacy approach has become significantly more nuanced through the operation of other corporate law principles, such as the business judgment rule.

The business judgment rule has played an important role in expanding director discretion to allow for consideration of corporate constituents other than shareholders. The rule developed, in part, due to judicial reluctance to interfere *ex post* with board decisions. Given the difficult nature of the determinations that directors make, and the potential for hindsight bias, courts have given deference to boards provided they act in good faith and on a reasonably informed basis. The impact of the business judgment rule has been to insulate many board decisions from court scrutiny. As noted by Iacobucci, “[b]usiness judgment deference gives corporate decision-makers wide discretion to make decisions that may in fact advance the interests of one group of stakeholders over another regardless of the precise formulation of the fiduciary duty.”¹⁷

¹² (1883), 23 Ch D 654 [*Hutton*].

¹³ *Ibid*.

¹⁴ (1919) 204 Mich 459 at 684, 170 NW 668 [*Dodge*].

¹⁵ *Dodge*, *supra* note 14 [Emphasis added].

¹⁶ Contra Gordon Smith, “The Shareholder Primacy Norm” (1998) 23 J of Corp L 277 (Smith argues that shareholder primacy was originally introduced to resolve disputes between majority and minority shareholders, not to place the interests of shareholders above stakeholders.)

¹⁷ Edward Iacobucci, “Indeterminacy and the Canadian Court’s Approach to Corporate Fiduciary Duties” (2009) 48 Can J Bus L 232 at 242 [*Iacobucci*].

In addition, corporations have long been involved in donating to charity. In 2000, corporations made over ten billion dollars in contributions.¹⁸ Interpreted strictly, shareholder primacy would not allow for such donations, as they relocate wealth from shareholders to other groups. However, the common law has developed a body of case law permitting corporate donations provided they are reasonable.¹⁹ The ability of corporations to give to charity is another illustration of how shareholder primacy has been diluted through different corporate law rules.

Finally, the oppression remedy requires that directors consider the reasonable expectations of other parties when making decisions. For example, directors may be required to consider the reasonable expectations of creditors where a given course of action impacts their interests. Although originally developed to protect the interests of minority shareholders, the oppression remedy has broadened to protect the expectations of other stakeholders.²⁰ The consequences of breaching the oppression remedy are severe and can include setting aside a corporate transaction.²¹ The oppression remedy is an example of a corporate law doctrine that specifically requires directors to consider the expectations of certain stakeholders (mainly creditors) when making a determination.

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

Although a strict approach to shareholder primacy has rarely been applied to director decision-making, one area where the theory has gained some traction with the courts is in the change of control context. Prior to *BCE*, two competing lines of case law developed with regard to directors' duties in the change of control context.²² The first line required directors to focus exclusively on maximizing shareholder value when it became clear that the corporation was going to be sold. The second line contemplated the consideration of groups outside of shareholders when making determinations with regard to changes in control. Each will be dealt with in turn.

¹⁸ Victor Brudney & Allen Ferrell, "Management and Control of the Modern Business Corporation: Corporate Speech and Citizenship: Corporate Charitable Giving" (2002) 69 U Chi L Rev 1191 at 1197.

¹⁹ See Adam Winkler, "Corporate Law of the Law of Business?: Stakeholders and Corporate Governance at the End of History" (2004) 67 Law & Contemp Probs 109 at 115-119 [*Winkler*].

²⁰ Courts have been reluctant to give employees standing to make claims under the oppression remedy. See, *Daniels v Fielder* (1988), 52 DLR (4th) 424 (Ont HC).

²¹ *BCA*, *supra* note 6 at s 241(3)(h).

²² There is some debate on the issue. See Darcy L MacPherson, "The Supreme Court Restates Directors' Fiduciary Duty – A Comment on *Peoples Department Store v. Wise*" (2005) 43 Alta L Rev 383 at 390 [*MacPherson*]. Compare Ian Lee "Peoples Department Stores v. Wise and the 'Best Interests of the Corporation'" (2004) 41 Can Bus LJ 212 at 216 [*Lee*] and Colin Feasby "Bondholders and Barbarians: BCE and The Supreme Court's New View on Directors' Duties" *The Annual Review of Civil Litigation* (Toronto: Thomson Carswell, 2009) at 97 [*Feasby*].

i. Maximizing Shareholder Value in the Change of Control Context

Certain Canadian courts have interpreted directors' fiduciary duties as requiring them to maximize shareholder value in the change of control context. In this respect, American corporate law has heavily influenced Canadian law. The duty to maximize shareholder value in the United States was articulated in *Revlon v MacAndrews & Forbes Holdings*.²³ In that case, the Delaware Supreme Court found that once the sale of a company is inevitable, a board has an obligation to maximize shareholder value through holding an auction.²⁴ This requirement is colloquially referred to as "Revlon duties".

The main justification for such a stringent rule is based on the inherent conflict of interest directors confront when involved in control transactions.²⁵ Where a corporation changes ownership, directors face the possibility that their position will be terminated. As such, there is a concern that directors will act in their own interests. The concern over self-interested directors was outlined in *Unocal Corp v Mesa Petroleum Co*, with Moore J. commenting that in the takeover context there is an "omnipresent spectre that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders."²⁶ By requiring directors to focus on the narrow mandate of maximizing shareholder value, the ability of a director to act in a self-interested manner is severely curtailed.

Subsequent courts have refined the principle outlined in *Revlon*. In *Paramount Communications, Inc v Time, Inc*,²⁷ the court commented on what circumstances trigger *Revlon* duties. According to Horsey J., *Revlon* duties will only be triggered where a corporation puts itself up for sale and initiates a bidding process to effect a reorganization involving a break up or when, in response to a bid, a company seeks an alternative transaction. The court essentially found that *Revlon* only applies where a company has determined to sell itself off to the highest bidder - at that point directors' duties are owed exclusively to the shareholders. As one commentator has argued, *Revlon* has been "tamed" by *Time*.²⁸

Further clarification on the content of *Revlon* duties was provided in *Paramount Communications v QVC*.²⁹ There the court interpreted *Revlon* in the following way: "when a corporation undertakes a transaction which will cause: (a) a change in corporate control; or (b) a break-up of the corporate entity, the directors' obligation is to seek the best value reasonably available to stockholders."³⁰ However, in a merger of two public companies, where both "would be owned by a fluid aggregation of unaffiliated

²³ *Revlon v MacAndrews & Forbes Holdings*, 506 A 2d 173 (Del SC 1985) [*Revlon*].

²⁴ *Ibid* at 12.

²⁵ A conflict of interest does not require an actual conflict but only the appearance of a conflict.

²⁶ *Unocal Corp v Mesa Petroleum Co*, 493 A 2d 946 (Del Super 1985) at 954 [*Unocal*].

²⁷ 571 A 2d 1140 (Del 1989) [*Time*].

²⁸ Theodore N Mirvis, "Time/Warner: The Delaware Supreme Court Speaks" (1990) 4 *Merg & Acq L Rep* 287.

²⁹ 637 A 2d 34 (Del 1993) [*QVC*].

³⁰ *Ibid* at 48.

stockholders both before and after the merger”, and neither company could be said to be acquiring the other, the court held there was no change of control and *Revlon* duties were not invoked.³¹ As with the decision in *Time*, *QVC* curtailed the circumstances in which *Revlon* duties arise. It is only when a corporation is actively engaged in a transaction, which changes corporate control or breaks up the corporate entity, that directors have an obligation to maximize shareholder value.

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

In *CW Shareholdings Inc v WIC Western International Communication Ltd*, the Ontario Court of Justice embraced *Revlon* duties. Blair J. noted, directors have a duty “to act in the best interests of the shareholders as a whole and to take active reasonable steps to maximize shareholder value by conducting an auction.”³² He went on to acknowledge the unavoidable conflict of interest that directors find themselves in when faced with a hostile takeover bid and advised that “retaining independent legal advice and financial advisors, and the establishment of independent or special directors” are additional responses to potential conflicts of interest.³³

In *Pente Investment Management Ltd v Schneider Corp*, the Ontario Court of Appeal had the opportunity to comment on directors’ fiduciary duties in the change of control context.³⁴ Weiler J. was of the opinion that directors are under an obligation to obtain “the best value reasonably available to shareholders in the circumstances.”³⁵ Although the court went on to reject the decision in *Revlon*, it is likely that the rejection was aimed at the procedural requirement of holding an auction rather than the obligation to maximize shareholder value.³⁶ As Weiler J. noted, an auction is just one way to minimize conflicts of interest during change of control transactions:

If a board of directors has acted on the advice of a committee composed of persons having no conflict of interest, and that committee has acted

³¹ *Ibid* at 46.

³² *CW Shareholdings Inc v WIC Western International Communication Ltd* (1998), 39 OR (3d) 755 (Gen Div [Commercial List]) at 768-769.

³³ *Ibid* at 769.

³⁴ *Pente Investment Management Ltd v Schneider Corp (sub nom Maple Leaf Foods Inc v Schneider)* (1998), 42 OR (3d) 177 (CA) [*Pente*].

³⁵ *Ibid* at 62.

³⁶ *Ibid* (The court noted that: “In Ontario, an auction need not be held every time there is a change in control of a company. An auction is merely one way to prevent the conflicts of interest that may arise when there is a change of control by requiring that directors act in a neutral manner toward a number of bidders...the obligation of directors when there is a bid for change of control is an obligation to seek the best value reasonably available to shareholders in the circumstances. This is a more flexible standard.” [Emphasis added])

independently, in good faith, and made an informed recommendation as to the best available value available to shareholders in the circumstances, the business judgment rule applies.³⁷

The Ontario Court of Appeal revisited the question of directors' duties in the change of control context in *Ventas Inc v Sunrise Senior Living Real Estate Investment Trust*. Here the court reiterated the shareholder-focused approach to the change of control context stating, "[t]here is no doubt that the directors of a corporation that is the target of a takeover bid ... has a duty to maximize shareholder (or unit holder) value in the process..."³⁸

ii. Contemplating Interests Outside of Shareholders

As the jurisprudence above indicates, there is a strong line of case law taking the position that directors' duties require them to maximize shareholder value in the change of control context. However, not all courts were in agreement. At the same time, a competing line of case law developed which took the position that directors' duties permit contemplation of non-shareholder interests in the change of control context.

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

I appreciate that it would be a breach of their duty for directors to disregard entirely the interests of a company's shareholder in order to confer a benefit on its employees... But if they observe a decent respect for other interests lying beyond those of the company's shareholder in the strict sense, that will not, in my view leave directors open to the charge that they have failed in their fiduciary duty to the company.³⁹

Commentators have argued *Tech* asserts the position that Canadian courts have recognized that a director's fiduciary duty contemplates considerations of corporate constituents in addition to shareholders.⁴⁰ Others have argued that the comments made by Berger J. were obiter⁴¹ and that these comments were not intended to reject shareholder primacy.⁴²

³⁷ *Ibid* at 38.

³⁸ *Ventas Inc v Sunrise Senior Living Real Estate Investment Trust* (2007), 85 OR (3d) 354 at para 34 (CA).

³⁹ *Tech Corp Limited v Millar* (1972), [1973] 2 WWR 385 at para 104 (BC SC).

⁴⁰ *Feasby*, *supra* note 22 at 97.

⁴¹ Wayne Gray, "Peoples v. Wise and Dylex: Identifying Stakeholder Interests Upon or Near Corporate Insolvency – Stasis or Pragmatism?" (2003) 39 CBLJ 242 at 243.

⁴² *MacPherson*, *supra* note 22 at 391.

The Supreme Court of Canada took the opportunity to remark on the decision in *Tech*, and their conception of directors' fiduciary duties in the case of *Peoples v Wise*.⁴³ Although the case did not involve a change of control transaction, the court here set down their position on the fiduciary duties of directors more broadly.

The case arose following the 1992 Wise stores acquisition of Peoples department stores. Within two years of the transaction, Peoples' business began to fall on tough times. In order to alleviate cost concerns the Wise brothers (who were directors and officers of both companies) decided to implement an inventory procurement policy.⁴⁴ Rather than purchasing separate inventory, the policy required inventory to be purchased by Peoples and subsequently be given to Wise on credit. The new inventory policy was ultimately unsuccessful and Peoples was forced into bankruptcy. At the time, Wise owed Peoples \$18 million for unpaid inventory.⁴⁵ The Trustee in Bankruptcy for Peoples alleged that the Wise brothers had breached their fiduciary duty to Peoples by placing the interests of Wise's creditors above Peoples' creditors.⁴⁶

When the case reached the Supreme Court of Canada, the court framed the issue to be determined as whether "directors owe a fiduciary duty to the corporation's creditors comparable to the statutory duty owed to the corporation."⁴⁷ The court rejected the argument that directors owe a fiduciary duty to creditors and further stated that directors do not owe a fiduciary duty to any constituent making up the corporation. Accordingly to the court:

[I]t is clear that the phrase "best interests of the corporation" should be read not simply as the "best interests of shareholders". From an economic perspective, the "best interests of the corporation" means maximizing the value of the corporation. However, the courts have long recognized that various other factors may be relevant in determining what directors should consider in soundly managing with a view to the best interests of the corporation.⁴⁸

The court rejected shareholder primacy, finding that directors may consider interests outside of shareholders when making decisions. Rather than simply focusing on shareholder value, a director is required to act in the best interests of the corporation. In doing so they *may* consider a variety of groups including, *intra alia*, shareholders, employees, suppliers, creditors, consumers, governments and the environment.⁴⁹

⁴³ It has been argued that the Supreme Court was not obligated to take a position on the issue at all. See, *Khimji*, *supra* note 10.

⁴⁴ *Peoples*, *supra* note 4 at 15.

⁴⁵ *Ibid* at 20.

⁴⁶ *Ibid* at 25.

⁴⁷ *Ibid* at 1.

⁴⁸ *Peoples*, *supra* note 4 at 42 [Emphasis added].

⁴⁹ *Ibid* at 42.

Directors should strive to create “a ‘better’ corporation, and not to favour the interests of any one group of stakeholders.”⁵⁰

The *Peoples* decision seemed to raise more questions than answers. It remained unclear whether directors were *required* to consider the interests of stakeholders and if directors could make a decision that favoured stakeholders’ interests over that of shareholders. Also, as the case arose outside of the change of control context, commentators were left wondering whether the law outlined in *Peoples* would apply in that context.⁵¹

C. The BCE Decision

In *BCE v 1976 Debentureholders*, the Supreme Court grappled with some of the questions that emerged from their decision in *Peoples*. *BCE* involved a \$52 billion transaction, the largest leverage buy-out in Canadian history, to be effected by a plan of arrangement under the *CBCA*.⁵² The transaction came about when BCE’s board decided to put the company in play. The board established a special committee, which was charged with the objective of “maximizing the interests of shareholders while respecting the rights of bondholders.”⁵³ The committee set up an auction process that elicited three bids, all of which were structured as leveraged buy-outs.

The highest bid was made by a consortium led by Ontario Teachers’ Pension Plan and represented a 40% premium to the closing price of BCE shares. Under the arrangement, Bell Canada, a wholly owned subsidiary of BCE, would be required to guarantee approximately \$30 billion of new debt.⁵⁴ Ninety-Seven percent of shareholders approved the arrangement.⁵⁵

The increased debt load of Bell Canada resulted in its debentures being downgraded below investment grade and a subsequent drop in trading value by approximately 20%.⁵⁶ In response, the debentureholders launched a challenge claiming the transaction was oppressive under section 241 of the *CBCA* and not fair and reasonable under section 192 of the *CBCA*.

At trial, the Quebec Superior Court dismissed the oppression claim and approved the transaction as fair and reasonable.⁵⁷ The court reasoned that in these circumstances the

⁵⁰ *Ibid* at 47.

⁵¹ Wayne Gray, “A Solicitor’s Perspective on *Peoples v. Wise*” (2005) 41 Can Bus LJ 184 at 189-190 [Gray].

⁵² The Quebec Superior Court’s decision is comprised of five separate judgments: *BCE Inc, Re* (2008), 43 BLR (4th) 1 (Que. S.C.); *BCE Inc, Re* (2008), 43 BLR (4th) 39 (Que SC); *BCE Inc, Re* (2008), 43 BLR (4th) 69; *BCE Inc, Re* (2008), 43 BLR (4th) 79 (Que SC) [*BCE Trial Oppression*]; *BCE Inc, Re* (2008), 43 BLR (4th) 135 (Que SC).

⁵³ *Ibid* at 52.

⁵⁴ *Ibid* at 89.

⁵⁵ *BCE supra*, note 5 at 19.

⁵⁶ *Ibid* at 4.

⁵⁷ *BCE Trial Oppression, supra* note 52.

board had acted reasonably in determining that their fiduciary duty required them to maximize shareholder value. The reasonable expectations of the debentureholders were restricted to the contractual agreements in place.⁵⁸

The Quebec Court of Appeal reversed the trial court's ruling and refused to approve the transaction.⁵⁹ The court, relying on *Peoples*, rejected the position that the board had an obligation to maximize shareholder value.⁶⁰ They further stated the board was required to consider the interests and reasonable expectations of the debentureholders. The court was of the opinion that statements made in offering materials and public reports created reasonable expectations among debentureholders that BCE would structure the deal in a way that did not negatively impact their financial interests.⁶¹ As BCE failed to produce any evidence that they attempted to accommodate the debentureholders' reasonable expectations, the court was unable to find the arrangement to be fair and reasonable.⁶²

The Supreme Court of Canada overturned the Quebec Court of Appeal decision. The court determined that the plan of arrangement was fair and reasonable and that the BCE board did not act oppressively towards the debentureholders. The court found the board had considered the debentureholders' reasonable expectations and acted reasonably in accepting the highest offer.⁶³ The unanimous court again took the opportunity to comment on directors' fiduciary duties and how those duties interact with the oppression remedy. The following sub-parts outline the approach the court in *BCE* took to fiduciary duties and the oppression remedy.

i. What Does the Fiduciary Duty Entail?

The court noted that a director's fiduciary duty is a "broad, contextual concept".⁶⁴ The content of the duty will vary depending on the situation at hand and there are no absolute rules. The duty is mandatory and, at minimum, it requires directors to ensure that the corporation meets its statutory obligations.⁶⁵

ii. To Who Is the Duty Owed?

The court affirmed *Peoples* and stated that the fiduciary duty is owed to the corporation. Directors are required to act in the best interests of the corporation.⁶⁶ No one particular set of interests is paramount. The corporation's interests are not synonymous with the interests of shareholders or any other stakeholder. They noted that, when the corporation

⁵⁸ *Ibid* at 133.

⁵⁹ *BCE Inc, Re* (2008), 43 BLR (4th) 157 (Que CA) [*BCE QCA*].

⁶⁰ *Ibid* at 99-100.

⁶¹ *Ibid* at 106.

⁶² *Ibid* at 117.

⁶³ *BCE, supra* note 5 at 113.

⁶⁴ *Ibid* at 66.

⁶⁵ *Ibid* at 37.

⁶⁶ *BCE, supra* note 5 at 66.

is a going concern, the duty of the director looks to the long-term interests of the corporation.⁶⁷

iii. Who May be Considered?

Although not mandatory, in certain circumstances, it may be appropriate to consider the interests of shareholders and other corporate stakeholders.⁶⁸ Affirming *Peoples*, the court stated that boards may look to the interests of shareholders, employees, creditors, consumers, government and the environment to inform their decisions.⁶⁹ Courts are to give appropriate deference to consideration of ancillary interests under the business judgment rule.⁷⁰ Thus, provided that it is “within a range of reasonable alternatives” to “take into account these ancillary interests” courts will not scrutinize a board’s decision.⁷¹

iv. Who Must Be Considered?

In certain circumstances, boards will be obligated to consider shareholder and stakeholder interests. The obligation arises under the oppression remedy, which requires directors to consider the reasonable expectations of all groups whose interests are implicated by a given course of action. When determining whether a party has reasonable expectations, factors such as commercial practice, the size, nature and structure of the corporation, the relationship between the parties, past practice, the failure to negotiate protection, agreements and representations and the fair resolution of conflicting interests are relevant considerations.⁷²

A fundamental component of a corporate constituent’s reasonable expectations includes being treated equitably and fairly.⁷³ Reasonable expectations are not confined to legal interests.⁷⁴ When making a decision that impacts a corporate constituent, the board will be obligated to consider their reasonable expectations. However, not all reasonable expectations give rise to oppression under section 241 of the *BCA*. In addition to showing reasonable expectations, a claimant must establish that the disregard of the reasonable expectations amounts to oppression, unfair prejudice, or unfair disregard in order to make a successful oppression remedy claim.

⁶⁷ *Ibid* at 38.

⁶⁸ *Ibid* at 39.

⁶⁹ *Ibid*.

⁷⁰ *Ibid* at 40.

⁷¹ *Ibid*.

⁷² *Ibid* at 106.

⁷³ *Ibid* at 70.

⁷⁴ *Ibid* at 102.

v. Where Interests Conflict?

The court recognized in certain circumstances the interests of corporate constituents may conflict.⁷⁵ Conflicting interests are to be resolved by directors by acting in “the best interests of the corporation”.⁷⁶ The oppression cases indicate that directors have a duty to treat stakeholders affected by corporate decision-making fairly and equitably.⁷⁷ However, provided that a decision is in a range of reasonableness, it will be protected under the business judgment rule.

No set of interests – for example shareholder interests – should prevail over other interests. However, the court did observe: “[t]he corporation and shareholders are entitled to maximize profit and share value, to be sure, but not by treating individual stakeholders unfairly.”⁷⁸ The court rejected *Revlon* and stated that the “fundamental rule” is that the duty of directors is “a function of business judgment of what is in the best interests of the corporation, in the particular situation it faces.”⁷⁹

When applying the above reasons to the case at hand, the court stated that “[i]n this case, the Board considered the interests of the claimant stakeholders. Having done so, and having considered its options in the difficult circumstances it faced, it made its decision, acting in what it perceived to be in the best interests of the corporation.”⁸⁰ Based on this analysis, the court determined that the BCE board had fulfilled their fiduciary duty and had not acted in an oppressive manner.

II. CRITIQUE OF THE CURRENT FIDUCIARY DUTY IN CANADA

The *BCE* decision has received a tremendous amount of attention since its release in December 2008. Commentators have commended the Supreme Court for the expedited manner in which it heard and rendered the decision.⁸¹ There clarify the decision in *Peoples*, it appears that the court further complicated the law with regard to directors’ fiduciary duties and how they operate in the change of control context.

This section of the paper will raise a number of issues with the BCE duty and how it applies to control transactions.⁸² Part A will argue that the BCE duty is indeterminate and raises a number of concerns, which result from such a duty. Part B will show how the BCE duty has left directors with no useful guidance for dealing with control

⁷⁵ *BCE*, *supra* note 5 at 64.

⁷⁶ *Ibid* at 81.

⁷⁷ *Ibid* at 82.

⁷⁸ *Ibid* at 64.

⁷⁹ *Ibid* at 87.

⁸⁰ *Ibid* at 104.

⁸¹ *Iacobucci*, *supra* note 17 at 233.

⁸² The remainder of the paper will refer to the duty as outlined in *Peoples* and *BCE* as the “BCE duty”.

transactions. Part C discusses how the Supreme Court's use of inconsistent theoretical conceptions of the corporation in *BCE* clouds the meaning of the decision.

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

The fiduciary duty outlined in *BCE* fails to meet a very basic rule of law: “laws should be written with reasonable clarity to avoid unfair enforcement.”⁸³ The BCE duty is vague, uncertain⁸⁴ and indeterminate.⁸⁵ The Supreme Court did not equate the term “best interests of the corporation” with any corporate constituent. Rather, the corporation is treated as an entity in and of itself, which directors are required to act in “the best interests of”. The difficulty with such a standard is that the term “best interests of the corporation” does not provide any guidance to directors confronted with a possible change of control transaction. The phrase is unclear. The ambiguity lies in the fact that the doctrine of corporate legal personality does not translate into fiduciary law.

Established in the seminal judgment of *Solomon v Solomon & Co.*⁸⁶, the doctrine of separate legal personality recognizes corporations as separate legal persons bearing the rights and capacities of a natural person. The purpose of this classification is to separate the assets and liabilities of the corporation from the individuals investing in it. From a policy perspective, the doctrine was introduced to encourage individuals to invest in corporations through the knowledge that they would not be personally liable for any debts or liabilities the corporation incurs.

Although classifying corporations as separate legal persons serves a useful function, the doctrine does not translate effectively into the fiduciary law context. The essential problem of articulating a director's duty in terms of “the best interests of the corporation” is that a corporation does not have independent interests in any meaningful sense. The categorization of corporations as legal persons is a matter of convenience rather than reality – it is a legal fiction.⁸⁷ It is the constituents that lay behind the corporation – employees, shareholders, creditors, suppliers, etc. – whose interests are implicated through the corporation's activities.

A corporation serves as a vehicle through which corporate constituents can pursue different ends. Each group will have independent purposes they hope to achieve through their interaction with the corporation. Shareholders seek to make returns on their investments, employees seek job security and wages, and creditors seek loan repayment.

⁸³ Lon Fuller, *The Morality of Law*, rev ed (New Haven, Conn: Yale University Press, 1969).

⁸⁴ *MacPherson*, *supra* note 22 at 402 (Arguing that rather than a fundamental shift to a stakeholder model, the court in *Peoples* simply “may have been trying to ‘tweak’ the law of directors’ duties, but they may have unintentionally gotten more than they bargained for.” at 396).

⁸⁵ *Iacobucci*, *supra* note 17 at 233-241.

⁸⁶ [1897] AC 22 (HL). The modern version of the doctrine is found in section 15 of the *CBCA* (“A corporation has the capacity and, subject to this Act, the rights, powers and privileges of a natural person.”)

⁸⁷ Frank H. Easterbrook and Daniel R. Fischel, “The Corporate Contract” (1989) 89 Colum L Rev 1416 at 1426 [*Easterbrook*].

Unlike any of those constituents, the legal entity known as the corporation has no independent goals or welfare concerns.⁸⁸

Where a given course of action benefits all stakeholders, acting in the “best interests of the corporation” will be a simple standard to satisfy. Directors can easily justify a decision as being in the “best interests of the corporation” if every corporate constituent benefits from it. Difficulties arise where constituent interests conflict. A change of control transaction represents a situation where the interests of corporate constituents have an increased likelihood of conflicting.⁸⁹ An effective fiduciary duty recognizes this probable conflict and provides a meaningful tool for resolving it. The indeterminate duty articulated in *BCE* provides directors with no useful guidance. As Professor MacIntosh points out, “[t]he Supreme Court appears to expect corporate directors, and judges *ex post facto*, to function as an enlightened breed of Philosopher Kings ardently and faithfully pursuing some elusive Aristotelian mean.”⁹⁰

The indeterminacy of the BCE duty is problematic on a number of levels. First, boards will have little guidance when making decisions.⁹¹ Directors are forced to wait for lower court decisions to explain how to discharge their duty.⁹² This problem is further magnified in the change of control context, where a predictable legal system allows for increased deal certainty.

Second, the increased discretion afforded to directors makes it ever more difficult to challenge board decisions.⁹³ The BCE duty provides an uncertain standard which limits directorial accountability.⁹⁴ Directors inclined on protecting their own interests may reject transactions under the guise of protecting a given stakeholder. Apart from blatantly self-interested or unreasonable board decisions, courts will be unlikely to interfere with director decision-making. Empowered with this insulation from challenge, dishonest directors may try to entrench themselves or misbehave in other ways.⁹⁵

⁸⁸ *Iacobucci*, *supra* note 17 at 235 (“[t]o speak of the legal fiction that is the corporation as having a ‘best interests’ is nonsensical. A legal fiction does not have welfare gains or losses that we care about” at 235.)

⁸⁹ One need not look further than the facts of *BCE* as an example of how various corporate constituents will not always agree on a given course of action. In *BCE* the shareholders stood to gain a 40% return while the debentureholders bonds were expected to decrease 20% in value.

⁹⁰ Jeffrey MacIntosh, “*BCE* and the Peoples’ Corporate Law: Learning to Live on Quicksand” (2009) 48 Can Bus LJ 255 at 256 [*MacIntosh*].

⁹¹ Alex Moore, “*BCE Inc. (Re): An Unexamined Question Considered*” (2009) 48 Can Bus LJ 273 at 278 [*Moore*].

⁹² *MacPherson*, *supra* note 22 at 402.

⁹³ *Gray*, *supra* note 51 at 190.

⁹⁴ James Tory, “A Comment on *BCE Inc.*” (2009) 48 Can Bus LJ 285 at 286 [*Tory*].

⁹⁵ *Feasby*, *supra* note 22 at 86 and 119; *MacIntosh*, *supra* note 90 at 255-256.

Finally, the indeterminate BCE duty is of little value to any corporate stakeholder. As explained by Macey and Millar, “fiduciary duties are not public goods.”⁹⁶ As more groups enjoy fiduciary protection, the value associated with such protection decreases. If directors are permitted to consider multiple constituents when making a decision, there is no guaranteeing that a particular group will take priority over another. Thus, a fiduciary duty that fails to provide certainty to a party protected by it will be of little to no value. Any protection provided by a fiduciary duty that allows for consideration of multiple parties is of minor significance, as a corporate constituent will never know if their interests will be guarded in a given circumstance.⁹⁷ There is little purpose in having a duty which provides no guarantee of protection for any party, be they shareholder or stakeholder.

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

One of the most dissatisfying aspects of the BCE judgment is what it does not say. The Supreme Court failed to comment on directors’ duties in the change of control context. The court ignored a substantial body of jurisprudence that has taken the position that where a corporation is involved in a change of control transaction, focus should be placed on maximizing shareholder value.⁹⁸

The Supreme Court took the position that, as a factual matter, BCE was “facing certain takeover” and that “BCE had been put in play, and the momentum of the market made a buyout inevitable.”⁹⁹ Commentators have questioned these assertions. Alex Moore points out that BCE was put in play through a decision of the board. He notes, “[t]o conclude that a buyout was inevitable overlooks the question of whether the BCE board could legitimately have taken steps to frustrate any change of control transaction through defensive tactics.”¹⁰⁰ It is clear that the market did not compel BCE to take the actions that it did, rather that the actions were a voluntary decision of the board who were acting on the notion that they had an obligation to maximize shareholder value.¹⁰¹

By construing the facts in such a way as to make the sale of BCE seem inevitable, the court sidestepped a very important issue: a board’s role when faced with a possible change of control transaction. It was generally accepted that directors were permitted to undertake defensive tactics provided that the purpose was to maximize shareholder value.¹⁰² Under the BCE duty it remains unclear the extent that directors will be permitted to pursue defensive tactics and when those tactics will be justified.¹⁰³ This

⁹⁶ Jonathan Macey & Geoffrey Miller, “Corporate Stakeholders: A Contractual Perspective” (1993) UTLJ 401 at 406 [*Macey and Miller*].

⁹⁷ *Ibid* at 406.

⁹⁸ See Section 1, Part B(i).

⁹⁹ *BCE*, *supra* note 5 at 106 and 112.

¹⁰⁰ *Moore*, *supra* note 91 at 276.

¹⁰¹ *Fadel*, *supra* note 2 at 203.

¹⁰² *Take-Over Bids – Defensive Tactics*, CSRA NP 62-202 (4 August 1997) [*Take-Over Rules*].

¹⁰³ It is unclear whether the decision will permit defensive tactics be used to protect the interests of stakeholders.

uncertainty is amplified when one examines how securities law addresses the responsibility of boards during control transactions.

Securities law plays an important role in regulating change of control transactions. Under securities law, directors are required to focus on the interests of shareholders when in the midst of a control transaction. National Policy 62—202 governs defensive tactics in Canada.¹⁰⁴ Although the policy is not strictly enforceable, it represents the position of securities regulators with respect to what actions a board will be permitted to take when faced with a change of control transaction.

The policy states that the primary objective of the take-over bid provisions in Canada is “the protection of the bona fide interests of the shareholders of the target company.”¹⁰⁵ Directors are permitted to “take action to maximize the return for shareholders.”¹⁰⁶ There is a preference for auctions in the policy, which also lists different defensive tactics that the regulators will find to be inappropriate.¹⁰⁷

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

C. *Do As I Say, Not As I Do: The Use of Polarized Conceptions of the Corporation*

A final criticism of the *BCE* decision is based on its seeming reliance on two polarized theories of the corporation. As discussed briefly above, shareholder primacy and stakeholder theory are two principal ways in which scholars conceptualize the corporation's role in society.¹⁰⁸ These two theories have very different normative underpinnings and following 80 years of debate, appear incapable of reconciliation.¹⁰⁹

The Supreme Court did not acknowledge the shareholder/stakeholder debate in *BCE*. If they had, they may have realised that they were utilizing elements of both theories. The court relied upon many ideas associated with stakeholder theory in its analysis of the oppression remedy. This is not surprising given that the oppression remedy was designed to protect the interests of stakeholders and minority-shareholders. However, the court

¹⁰⁴ *Take-Over Rules*, *supra* note 102.

¹⁰⁵ *Take-Over Rules*, *supra* note 102 at 1.1(2) [Emphasis added].

¹⁰⁶ *Ibid* at 1.1(1).

¹⁰⁷ *Ibid* at 1.1.

¹⁰⁸ See Note 3.

¹⁰⁹ The debate can be traced back to Dodd and Berle. See, Adolf Berle, “Corporate Powers in Trust” (1931) 44 Harv LR 1049 [*Berle*]; Edwin Dodd, “For Whom Are Corporate Managers Trustees?” (1931) 45 Harv LR 1145 [*Dodd*]; Adolf Berle, “For Whom Are Corporate Managers Trustees: A Note” (1932) 45 Harv LR 1365.

also utilized ideas associated with stakeholder theory when discussing the operation of directors' fiduciary duties.

Given the courts apparent preference towards a more stakeholder friendly model of corporate law, it is surprising that the ultimate decision in *BCE* fits squarely in line with what would be expected under shareholder primacy. Although *BCE* rejects *Relvon* and the notion that directors have an obligation to maximize shareholder value, the court found no fault in the board, which proceeded on the basis that their obligation required them to maximize shareholder value.¹¹⁰ The following discussion comments on this interesting inconsistency while further outlining stakeholder theory and shareholder primacy and how in *BCE* the court utilized both theories.

i. Stakeholder Theory

It should be noted from the outset that there is no definitive agreement on what stakeholder theory entails. Many early articulations of the theory have done so in the form of a negative critique towards shareholder primacy.¹¹¹ Stakeholder theorists have begun to produce more positive arguments; however, the premise is still in its early stages.¹¹² As such, the theory remains a relatively broad concept. It is clear from canvassing the extensive literature that stakeholder theory has differing meanings to different scholars. Although stakeholder theorists disagree about certain aspects of the theory, they are all unified in their position that corporations should not be run solely in the interests of shareholders. The Supreme Court agreed stating "it is important to be clear that the directors owe their duty to the corporation, not to shareholders..."¹¹³

Stakeholder theory provides an expansive view of the corporation. Early formulations of the theory can be traced back to the famous debate between Professor Berle and Professor Dodd in the *Harvard Law Review*. In debating for whom managers act as trustees, Dodd argued that shareholder interests can be subjugated to other stakeholders and society at large.¹¹⁴ The articulation of stakeholder theory in its current form can be traced to R. Edward Freeman and his influential book, *Strategic Management: A Stakeholder Approach*.¹¹⁵

Most legal scholars see stakeholder theory as part of a broader communitarian ideology. Stakeholder theory starts from the communitarian proposition that the purpose of the

¹¹⁰ *Feasby*, *supra* note 22 at 119.

¹¹¹ Andrew Keay, "Stakeholder Theory in Corporate Law: Has it got what it takes?" (4 January 2010) <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1531065> at 6 [*Keay*].

¹¹² David Millon, "New Direction in Corporate Law: Communitarians, Contractarians, and the Crisis in Corporate Law" (1993) 50 Wash & Lee L Rev 1373 at 1387.

¹¹³ *BCE*, *supra* note 5 at 66 [Emphasis added].

¹¹⁴ See *Dodd*, *supra* note 109.

¹¹⁵ R Edward Freeman, *Strategic Management: A Stakeholder Approach* (Boston: Pitman Publishing, 1984).

corporation is to promote overall social good.¹¹⁶ The theory rejects the idea that a corporation's sole purpose is making money. Corporations are recognized as important actors in society and not just an investment vehicle for owners of financial capital.¹¹⁷ This broader mandate was recognized in *BCE*, as the court repeatedly referenced the idea that corporations should strive to be a "good corporate citizen."¹¹⁸

One reason why stakeholder theory favours a broad public mandate for corporations is due to their external influence. Stakeholder theory conceptualizes corporations as large and influential institutions whose conduct can have substantial impact on society.¹¹⁹ Of the largest 150 economic entities in the world, 95 are corporations.¹²⁰ Given the powerful position that corporations hold, stakeholder theorists argue that corporations have an obligation to society. For stakeholder theorists, if corporations are permitted to focus solely on profit maximization, a potential opportunity for societal betterment is lost.

In addition to the external influence of corporations, stakeholder theory focuses on the wide range of interests, which make up the corporation. The Supreme Court recognized this in *BCE* stating: "a corporation is an entity that encompasses and affects various individuals and groups."¹²¹ Stakeholder theorists argue that each corporate constituent is integral to the success of the corporation.¹²² Each of these parties (not just shareholders) makes firm-specific investments. It would be unfair for directors to ignore the interests of the parties that contribute to the success of the corporation and focus only on shareholders. The notion of fair treatment of stakeholders was introduced in the Supreme Court's discussion of the reasonable expectations doctrine under the oppression remedy: "The corporation and shareholders are entitled to maximize profit and share value, to be sure, but not by treating individual stakeholders unfairly. Fair treatment – the central theme running through the oppression jurisprudence – is most fundamentally what stakeholders are entitled to reasonable expect."¹²³ The courts comments parallel stakeholder theorist arguments that because each stakeholder contributes to the corporation, they should be treated fairly and benefit from their contributions.¹²⁴

The Supreme Court's utilization of numerous ideas associated with stakeholder theory in *BCE* has led some commentators to argue that *BCE* has introduced a stakeholder model

¹¹⁶ Benedict Sheehy, "Scrooge-The Reluctant Stakeholder: Theoretical Problems with the Shareholder-Stakeholder Debate" (2005) 14 U Miami Bus L Rev 193 at 237 [Sheehy].

¹¹⁷ David Millon, "Redefining Corporate Law" (1990) 24 Ind L Rev 224 at 226 [Millon Redefine].

¹¹⁸ *BCE supra*, note 5 ("Directors acting in the best interests of the corporation, may be obliged to consider the impact of their decisions on corporate stakeholders" at 66).

¹¹⁹ Jeffery Bone, "Corporate Social Responsibility in the Wake of the Supreme Court Decision of *BCE Inc. and Bell Canada*" (2009) 27 Windsor Rev Legal & Soc Issues 6 at 8.

¹²⁰ Rhett Butler, "Corporations among largest global economic entities, rank above many countries" (18 July 2005) <http://news.mongabay.com/2005/0718-worlds_largest.html>

¹²¹ *BCE, supra* note 5 at 64.

¹²² Tuvai Borok, "A Modern Approach to Redefining the Best Interests of the Corporation" (2003) 15 Windsor Rev Legal & Soc Issues 114 at 125.

¹²³ *BCE, supra* note 5 at 64.

¹²⁴ *Keay, supra* note 111 at 6.

of directors' fiduciary duties to Canada.¹²⁵ Although this likely overstates the impact of the decision, it is clear that the court emphasized the importance of stakeholders and ensuring that their rights are not disregarded. Notwithstanding the courts repeated emphasis on protecting stakeholder interests, the ultimate result of the case was that a bid that provided a significant premium to shareholders (and a loss to debentureholders) was approved. This result is in keeping with what would be expected under shareholder primacy and contractarian theory.

ii. Shareholder Primacy and Contractarian Theory

At present, contractarian theory is considered by many scholars to provide the strongest underpinning for shareholder primacy.¹²⁶ The theory, which has become the dominant scholarly approach to corporate law, conceptualizes the corporation as a nexus of contracts.¹²⁷ Early articulations of the theory can be traced back to the work of Ronald Coase, who suggested that the corporation served as “a vehicle that internalized the multiple relationships existing between the various constituencies.”¹²⁸ Jensen and Meckling later adapted this approach. To these scholars, the corporation was a legal fiction that served as a nexus of contracting relationships that took place between the corporation and the various owners of labour, capital inputs and outputs, and materials.¹²⁹ In order to minimize agency problems resulting from the separation of ownership and control, it was thought that shareholders should be given exclusive right to control the firm.

Frank Easterbrook and Daniel Fischel added to the nexus of contract approach with their seminal work, *The Economic Structure of Corporate Law*.¹³⁰ Like those before them,

¹²⁵ See *Tory*, *supra* note 94. (“However, the court, from its reasons in *BCE*, seems to have been unaware that there is even a debate, let alone that its rejections of shareholder primacy and its adoptions of a pure stakeholder approach to corporate fiduciary duties makes us an outlier in the Anglo-American corporate world” at 286 [Emphasis added]).

¹²⁶ Prior to contractarian theory, shareholder primacy was usually justified on the basis that shareholders owned the corporation. Proponents of the argument were of the view that as owners, shareholders were the most deserving of the protection afforded by an exclusive fiduciary duty. This position was advocated by scholars such as Adolf Berle and Milton Freedman. As time passed scholars begin to critique the shareholder-as-owner analogy. Critics argued that shareholders did not own the corporation in any real sense, rather simply owed their shares. Shareholders had no rights to the corporation's assets or earnings and no control over operation decisions. See Lynn Stout, “Bad and Not-So-Bad Argument for Shareholder Primacy” (2002) 75 S Cal L Rev 1189 at 1190-1192.

¹²⁷ Jonathan Macey, “Fiduciary Duties As Residual Claims: Obligations to Non-shareholder Constituencies From a Theory of the Firm Perspective” (1998) 84 Cornell L Rev 1266 at 1266 – 1267 [Macey].

¹²⁸ Ronald Coase, “The Nature of the Firm” in Richard Posner and Kenneth Scott, *Economics of Corporate Law and Securities Regulation* (Toronto: Little Brown & Company, 1980) at 3-7.

¹²⁹ Micheal Jensen & William Meckling, “Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure” (1976) 3 J Fin Econ 305.

¹³⁰ Frank Easterbrook & Daniel Fischel, *The Economic Structure of Corporate Law* (Cambridge: Harvard University Press, 1991).

Easterbrook and Fischel focused on the role of voluntary ordering with regard to corporate governance:

The corporation is a complex set of explicit and implicit contracts, and corporate law enables the participants to select the optimal arrangement for the many different sets of risks and opportunities that are available in large economy. No one set of terms will be best for all; hence the 'enabling' structure of corporate law.¹³¹

Easterbrook and Fischel added further to contractarian theory with their analysis of shareholders' residual claimant status. A residual claim is a claim to a share of a corporation's earnings, after all debt obligations have been satisfied. For each share, a shareholder is entitled to the proportional value of the corporation after all other debts have been paid off. Thus, shareholders "get only what is left over - but they get all that is left over."¹³²

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

According to Easterbrook and Fischel, shareholders' status as residual claimants justifies their interests being placed above all other stakeholders.¹³³ Shareholders have an incentive to ensure that the corporation will be run in such a way as to maximize residual earnings. The more profit a corporation earns over and above their fixed claims, the greater the benefit for all stakeholders.

In addition to shareholders' incentive to increase residual earnings, contractarians argue that the ability of stakeholders to contract with the corporation places them in advantageous position *vis-à-vis* shareholders. Stakeholders have the ability to negotiate protections for themselves: employees enter into employment contracts and have the ability to negotiate the terms of those contracts, creditors enter into loan agreements that specify interest rates and allocate certain risks, etc. On the other hand, shareholders do not have the ability to set any terms in return for their investment of capital. For contractarians, the inability of shareholders to protect themselves through contract provides another justification for exclusive fiduciary protection.

The result in *BCE* falls in line with what would be expected under a shareholder primacy or contractarian approach to corporate law. The board designed a process to capture the most value available for shareholders. Although the board considered the interests of

¹³¹ Easterbrook, *supra* note 87 at 1418.

¹³² *Ibid.* at 1425.

¹³³ Easterbrook, *supra* note 87 at 1425.

debentureholders, they were correct in dismissing them because the debentureholders had the ability to protect themselves through contract and failed to do so.¹³⁴ As such, even with all of the court's stakeholder friendly rhetoric, the shareholders were still ultimately successful as the bid was approved by the court. Colin Feasby has commented on this interesting inconsistency:

[t]he Supreme Court's reasons in *BCE* appear to herald a softer and gentler corporate law... and simultaneously deploy contractarian analysis to arrive at a pro-shareholder result. As a result, *BCE* provides no clear standard or guidance to boards of directors confronting similar circumstances in the future.¹³⁵

III. SHAREHOLDER PRIMACY: THE SUPERIOR APPROACH

As the previous section has shown, there are many problems associated with the BCE duty. This portion of the paper argues that the largest potential issue with the duty involves its approach to change of control transactions. Control transactions represent circumstances where shareholders are most vulnerable to abuse by directors. As such, protections must be put in place in order to ensure that shareholder interests are not disregarded. In order to address these concerns, this paper proposes a fiduciary duty that requires directors to focus exclusively on maximizing shareholder value in the change of control context.

This section will be divided into four parts. Part I will begin by examining why the change of control context necessitates shareholder protection by an exclusive fiduciary duty. The remaining parts will propose and critically examine a variety of arguments in favour of shareholder wealth maximization in the change of control context.

A. *Why an Exclusive Duty is needed in the Change of Control Context*

What is it about the change of control context that makes it necessary for directors to focus exclusively on maximizing shareholder value? To be sure, most arguments made in favour of a duty to maximize shareholder value in the change of control context would apply with equal force to other decisions impacting a corporation. Speaking to this question Professor Iacobucci has argued "there is no reason to conclude that shareholders should suddenly matter, and that other stakeholders should suddenly recede in importance, when a takeover bid arises."¹³⁶

This paper seeks to provide an argument as to why the change of control context mandates different fiduciary duties. From a practical perspective, exclusive fiduciary duties are not necessary outside the change of control context because directors' interests are sufficiently aligned with shareholders through other means. Where a corporation is

¹³⁴ *BCE*, *supra* note 5 at 108.

¹³⁵ *Feasby*, *supra* note 22 at 216.

¹³⁶ *Iacobucci*, *supra* note 17 at 250.

operating as a going concern, shareholders are protected through legal and market-based incentives that fuse the interests of directors with that of shareholders.

Shareholder power to elect directors provides an incentive for directors to consider the interests of shareholders above that of non-shareholders.¹³⁷ Shareholders also have the ability to requisition a meeting where the entire board may be removed.¹³⁸ Although traditionally the right to elect and remove directors has not provided a significant obstacle on management behavior, the current position is not as clear.¹³⁹ Professors Hansmann and Kraakman argue that shareholders have a more powerful voice than ever before because institutional investors “not only give effective voice to shareholder interests, but promote the voice of dispersed public shareholders.”¹⁴⁰

In contrast, Professor Bainbridge has criticized the idea that shareholder-voting rights impact director decision-making. He observes, “in practice...even the election of directors, absent a proxy context, is predetermined by the existing board nominating the next board.”¹⁴¹ In addition, he points to evidence that activism among institutional shareholders has had little impact on director decision-making.¹⁴²

Ultimately, it is difficult to say with any degree of empirical certainty the extent to which shareholder ability to elect and remove directors impacts board decision-making. However, all things being equal, the election power may tip the scales slightly in the favour of shareholders. As Millon points out, “in cases in which management must choose between promoting shareholder welfare at a cost to non-shareholders or protecting non-shareholders at the shareholders’ expense, the existence of shareholder voting rights encourages management to prefer the former option.”¹⁴³

Executive compensation schemes provide another incentive for directors to favour the interests of shareholders.¹⁴⁴ Public companies are increasingly compensating directors with shares and requiring them to hold a significant number of their securities.¹⁴⁵ Indeed, the Canada Coalition for Good Governance lists share ownership as one of its guiding principles of executive compensation: “The compensation committee should require executives to build and maintain a significant equity investment in the company.

¹³⁷ See *CBCA*, *supra* note 6 at s 137(4).

¹³⁸ *Ibid* at s. 143.

¹³⁹ Lucian Ayre Bebchuk, “The Case Against the Board Veto in Takeovers” (2002) 69 U Chi L Rev 976.

¹⁴⁰ Henry Hansmann & Reiner Kraakman, “The End of History of Corporate Law” (2000) 89 Geo LJ 439 at 453.

¹⁴¹ *Bainbridge*, *supra* note 3 at 569.

¹⁴² *Ibid* at 571.

¹⁴³ *Millon Redefine*, *supra* note 117 at 261.

¹⁴⁴ *Millon Redefine*, *supra* note 117 at 261.

¹⁴⁵ Shamsud Chowdhury, “Director Compensation: The Growing Popularity of Deferred Stock Units” (January/February 2009) Ivey Bus J

<http://www.iveybusinessjournal.com/article.asp?intArticle_ID=806> [*Chowdhury*].

Consideration should be given to holding periods beyond retirement.”¹⁴⁶ The underlying rationale for this type of compensation is that when directors have a financial stake in the corporation, they will perform their role at an optimal level. A byproduct of compensating directors with shares is that it gives them a pecuniary incentive to favour the interests of shareholders.¹⁴⁷

There are also a variety of market-based incentives that align the interests of directors and shareholders. These incentives are the result of pressure placed on directors to compete effectively in their market. Although market based incentives may not guarantee that management always focuses exclusively on shareholder interests, “they still generate systematic pressure that lead management away from costly policies beneficial to non-shareholders.”¹⁴⁸

Product or market competition between firms is one market-incentive that aligns the interests of shareholders and directors. Directors are under pressure to reduce costs in order to remain competitive with other firms in their industry. Millon gives the example of a firm deciding whether or not to shut down an old factory to reduce costs.¹⁴⁹ Failure to do so may put the firm at a disadvantage *vis-à-vis* their competitors. Given these concerns, management is encouraged to pursue efficiency over non-shareholder interests.¹⁵⁰ Millon also argues that focus on non-shareholder interests may put firms at a disadvantage when attempting to secure debt financing or additional equity financing.¹⁵¹ Given the variety of incentives directors have to favour the interests of shareholders, it is not surprising that even strong supporters of stakeholder based models of corporate governance have conceded: “if there is no legal requirement that management protect non-shareholders, it is unlikely they will do so.”¹⁵²

However, the change of control context presents a circumstance where directors’ self-interest has a greater potential to conflict with shareholder interests. When a corporation is changing ownership, there is a strong possibility that directors may lose their jobs.¹⁵³ Many takeovers are the result of mismanagement and provide a tool for reallocating economic resources to their best use. Given the negative consequences that takeover bids may have on directors, concern over their livelihood may take precedent over and above the legal and market incentives, which tie their interests to that of shareholders.

In order to avoid potential self-interested actions, it is necessary that directors involved in change of control transactions have an obligation to look exclusively towards the interests of shareholders when making decisions. Market incentives no longer function to

¹⁴⁶ Canadian Coalition for Good Governance, “2009 Executive Compensation Principles” (May 2009) <http://www.ccg.ca/site/ccgg/assets/pdf/2009_Executive_Compensation_Principles.pdf>

¹⁴⁷ Chowdhury, *supra* note 145.

¹⁴⁸ Millon *Redefine*, *supra* note 117 at 262.

¹⁴⁹ *Ibid* at 262.

¹⁵⁰ *Ibid*.

¹⁵¹ *Ibid* at 262-263.

¹⁵² *Ibid* at 264.

¹⁵³ Unocal, *supra* note 26.

align the interests of directors with shareholders, as it is unlikely they will be working with the company in the near future. If directors can justify their decision-making on the basis that it protects the welfare of a given stakeholder, they are presented with the opportunity to act in their own interests. Although most directors will not act on such an opportunity, legal constraints are nonetheless necessary in order to achieve adequate shareholder protection.

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

Whether an exclusive fiduciary duty provides the best means of protecting shareholders is a matter of debate. It could be argued that the use of a special committee composed of independent directors, in addition to fairness opinions by independent advisors, are sufficient methods of ensuring that self-interested directors do not taint decisions. This paper takes the position that although there are other mechanisms that can be used to protect shareholders, fiduciary duties are best suited at doing so.¹⁵⁴ The following parts will examine certain arguments in favour of shareholder primacy and why it is the preferable approach to dealing with control transactions.

B. Shareholder Primacy Provides a Coherent and Enforceable Duty

In contrast to the uncertain and indeterminate BCE duty, one of the strongest arguments in favour of shareholder primacy in the change of control context is that it provides a coherent and enforceable rule that is easy for directors to follow. Directors have a clear measuring stick on which to base their decisions. In addition, shareholder wealth maximization provides a strong enforcement mechanism for misbehaving directors. Shareholder primacy “draws the clearest line between decisions that breach the fiduciary duty [and those that do not].”¹⁵⁵ Directors can be monitored relatively easily when their performance is measured through inspection of share price. Robert Clark put it this way:

A single objective goal like profit maximization is more easily monitored than a multiple, vaguely defined goal like the fair and reasonable accommodation of all affected interest.... Assuming shareholders have some control mechanisms, better monitoring means that corporate managers will be kept more accountable. They are more likely to do what they are supposed to do and do it efficiently.¹⁵⁶

¹⁵⁴ See Section III Part D.

¹⁵⁵ Jeffrey MacIntosh, “Designing an Efficient Fiduciary Law” (1993) 43 UTLJ 425 at 457 [*MacIntosh Fiduciary Duty*].

¹⁵⁶ Robert Clark, *Corporate Law* (Boston: Little, Brown and Company, 1986) at 20.

Shareholder primacy provides a simplified standard for courts to determine whether a director has breached his or her fiduciary duty. Easy monitoring will improve corporate efficiencies and reduce agency costs.¹⁵⁷ During control transactions, directors would be required to show that a transaction is in the best interests of shareholders. This determination would primarily focus on share price; however, other considerations such as deal certainty, fairness opinions and formal valuations would factor in as well.

Although shareholder primacy provides a coherent framework for directorial accountability it is not without its flaws. Determining what is in the “best interests of shareholders” may prove to be difficult, if not impossible.¹⁵⁸ What one shareholder may perceive to be in their best interests may contrast starkly with the views of another. Shareholders may have different investment horizons.¹⁵⁹ While long-term investors may focus on the lasting viability of the corporation, other shareholders, such as arbitrageurs, may focus exclusively on short-term returns. Further, the makeup of a shareholder’s portfolio may impact their perceived best interests. The interests of diversified shareholders will be very different from the interests of undiversified shareholders.¹⁶⁰

While shareholder interests are by no means monolithic, of all corporate constituents they are the most likely to agree on a given issue. There is no other stakeholder group as homogenous as shareholders.¹⁶¹ Employee interests may conflict on relative wages and on many of the “firm’s investment decisions, such as which plants to keep open, which processes to automate, or where to improve safety.”¹⁶² Similarly, secured and unsecured creditors’ interests may be substantially divided, “secured creditors will generally be less hostile to increases in firm risk than will unsecureds, since they are better protected in the event of insolvency.”¹⁶³ Shareholders, on the other hand, are likely to be unified in their desire to increase the residual value of the corporation.

In any event, the fact that shareholder interests diverge does not provide a strong argument for having directors consider additional divergent interests. As pointed out by James Hanks: “[i]t is a non sequitur to argue that because it is difficult for directors to determine the best interests of a large, diverse group of stockholders, the directors should therefore be authorized to determine the best interests of an even larger, more diverse group of nonshareholders.”¹⁶⁴

¹⁵⁷ Mark Van Der Weide, “Against Fiduciary Duties to Corporate Stakeholders” (1996) 21 Del J Corp L 27 at 69 [*Van Der Weide*].

¹⁵⁸ Steven Wallman, “The Proper Interpretation of Corporate Constituency Statutes and Formulation of Directors’ Duties” (1991) 21 Stetson L Rev 163 at 173-174 [*Wallman*].

¹⁵⁹ *Ibid.*

¹⁶⁰ *Ibid.*

¹⁶¹ Roberta Romano, “Metapolitics and Corporate Law Reform” (1984) 36 Stan L Rev 923 at 952-953.

¹⁶² Henry Hansmann, *The Ownership of Enterprise* (Cambridge: Harvard University Press, 1996) at 90.

¹⁶³ *MacIntosh Fiduciary Duty*, *supra* note 155 at 455.

¹⁶⁴ James Hanks, “Playing with Fire: Nonshareholder Constituency Statutes in the 1990s” (1991) 21 Stetson L Rev 97 at 111.

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

C. Protecting Stakeholders in the Change of Control Context

Critics of shareholder primacy argue that change of control transactions allow shareholders to transfer stakeholder wealth to themselves. Speaking of the American hostile takeover market in the 1980s, Karmel notes: “bondholders have complained that the size of a takeover premium reflected a portion of their capital.”¹⁶⁵ Often, employees complain they have been deprived of their human capital contributions to a corporation when layoffs followed a takeover.¹⁶⁶

Stakeholder theorists have argued that the gains experienced by shareholders during hostile takeovers come at the expense of stakeholders. In economic terms, it was argued that shareholder gains were redistributed from labour or bondholders. As time passed, scholars began to question the empirical validity of the redistribution argument. Studies now show that the gain shareholders collect during change of control transactions do not come at the expense of stakeholders.¹⁶⁷ Daniels explains the situation in this way:

In most cases, both the shareholders and the stakeholders lost the investment made in the stakeholders’ firm specific capital. If a corporation is forced to displace a stakeholder whose firm-specific capital has depreciated more quickly than anticipated, this is a loss both for the corporation (that is, shareholders) and the stakeholder. The reason why shareholders gain – despite the loss related to obsolete stakeholder firm-specific capital – is that there are other related gains (synergies, improved management, monopoly profits, tax benefits) from a takeover that are split between acquiring and target shareholders.¹⁶⁸

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

¹⁶⁵ Robert Karmel, “Implications of the Stakeholder Model” (1992) 61 *Geo Wash L Rev* 1156 at 1172.

¹⁶⁶ See generally, Katherine Van Wezel Stone, “Policing Employment Contracts Within the Nexus-of-Contracts Firm” (1993) 43 *UTLJ* 353.

¹⁶⁷ For a literature review see Roberta Romano, “A Guide to Takeovers: Theory, Evidence, and Regulation” (1992) 9 *Yale J on Reg* 119, 136-142.

¹⁶⁸ Ron Daniels, “Stakeholders and Takeovers: Can Contractarianism be Compassionate?” (1993) 43 *UTLJ* 425 at 334 [*Daniels*].

It is also clear that although shareholder gains are not redistributive, stakeholder interests may nonetheless suffer as a result of control transactions. Stakeholders form an integral part of any successful corporation and have valid interests worth protecting. Control transactions may result in stakeholders suffering considerable losses. For example: employees have sometimes lost their jobs, endured pension benefit reductions and decreases in wages, creditors may suffer as a result of increased debt load, which reduces the value of their products, and local communities may lose tax revenue.

Stakeholder theorists argue that protections need to be put in place to mitigate any damages resulting from control transactions. There is a plethora of thought regarding how best to ensure that stakeholder interests are not disregarded. Some commentators argue that stakeholders should be given seats on boards.¹⁶⁹ Others feel that fiduciary protection provides the best solution.¹⁷⁰ This paper argues that stakeholder protection is most effectively dealt with outside the realm of fiduciary protection through the mechanisms of contract, legislation and the political process. Although individually these modes of protection suffer from different short-fallings, collectively they provide an effective regime for ensuring that the interests of stakeholders are upheld. At the same time, by using these protective mechanisms rather than fiduciary duties, concerns regarding diluted duties and the accompanying potential for management opportunism are reduced.¹⁷¹ The following sub-parts will examine the protection mechanisms of contracting, legislation and the political process.

i. Contracting

Stakeholder's first line of protection is afforded through their ability to contract with the corporation. Stakeholders have the "technological" ability to protect their interests through agreement.¹⁷² Stakeholders can shield themselves against almost every type of director misbehavior by retaining negative control over the corporation's operations. Bondholders, workers and even local communities have the ability to protect their interests by contracting for the right to veto future proposed action by directors.¹⁷³

Speaking specifically to the change of control context, stakeholders have a wide range of contractual mechanisms they can utilize in order to protect their interests. Workers and employees can negotiate golden parachutes.¹⁷⁴ Creditors, such as bondholders, can

¹⁶⁹ This type of corporate governance model is more common in Europe and Japan. See generally Marc Lowenstein, "Stakeholder Protection in Germany and Japan" (2001) 76 Tul L Rev 1673.

¹⁷⁰ Ronald Green, "Shareholders as Stakeholders: Changing Metaphors of Corporate Governance" (1993) 50 Wash & Lee L Rev 1409 (Green argues that "fiduciaries of various sorts commonly find themselves pulled between competing duties... why cannot corporate directors and senior managers be asked to do the same?" at 1418.) [*Green*].

¹⁷¹ See Section 1, Part A.

¹⁷² Jonathan Macey, "An Economic Analysis of the Various Rationales for Making Shares the Exclusive Beneficiaries of Corporate Fiduciary Duties" (1991) 21 Stetson L Rev 23 at 40.

¹⁷³ *Macey and Miller*, *supra* note 96 at 417.

¹⁷⁴ *Van Der Weide*, *supra* note 157 at 42; *BCE*, *supra* note 5 at 108.

utilize poison put and control and credit rating covenants.¹⁷⁵ Stakeholder's ability to protect themselves through contract places them in a unique and favourable position. Although fiduciary duties provide broad and sweeping protection, they do so in the form of gap filling devices. Macey makes the point that "fiduciary duties only operate in the shadow of the express contractual arrangements that nonshareholders constituencies have with the firm."¹⁷⁶ Thus, in the change of control context, fiduciary duties to maximize shareholder value do not void any contractual protections that stakeholders have in place. Shareholders are entitled to maximize value, but only after all contractual obligations are honoured.

Although contracting provides a powerful tool for stakeholder self-protection, there are a number of practical impediments, which reduce its effectiveness in certain situations.¹⁷⁷ Firstly, it is difficult for parties to plan for all future contingencies when drafting a contract. Unforeseen circumstances may arise and attempting to plan for every eventuality through contract is impossible. Further, asymmetric information between contracting parties reduces the potential for meaningful protection of stakeholders. Daniels points out serious infirmities that plague the stakeholder-corporation bargaining environment:

Information regarding the likelihood and magnitude of certain events may be unavailable or mistaken. Endemic agency problems may hobble the capacity of various stakeholder groups, for example, organized labour, to negotiate effectively, with management... [Further] certain legal infirmities may impair the capacity of stakeholders to enforce corporate undertakings.¹⁷⁸

It is clear that, in many circumstances, the reality of contractual formation impedes stakeholders from achieving meaningful self-protection. In certain situations judges may be relied upon to provide "gap-filling functions"¹⁷⁹; however, judicial ex-post protection brings with it additional costs and elements of uncertainty.¹⁸⁰

In addition, disparity of bargaining position between stakeholders and the corporation may prevent stakeholders from negotiating meaningful contractual protection. As described by Zumbansen and Archer, "not all contracting parties engage in the bargaining process with the same pedigree of expertise and freedom from coercion."¹⁸¹ Although some stakeholders have the ability to contract with the corporation, those in

¹⁷⁵ *Ibid.* at 419.

¹⁷⁶ Macey, *supra* note 127 at 1275.

¹⁷⁷ See John Coffee, "Shareholder Versus Managers: The Strain in the Corporate Web" (1986) 85 Mich L Rev 1; William Bratton, "The Economic Structure of the Post-Contractual Corporation" (1992) 87 Nw U L Rev 180.

¹⁷⁸ Daniels, *supra* note 168 at 328.

¹⁷⁹ Macey and Miller, *supra* note 96 at 417-418.

¹⁸⁰ Morey McDaniel, "Stockholders and Stakeholders" (1991) 21 Stetson L Rev 121 at 155.

¹⁸¹ Peer Zumbansen & Simon Archer, "The BCE Decision: Reflections on the Firm as a Contractual Organization" (2009) 4 CLPE Research Paper Series 1 at 14 [Zumbansen].

weak bargaining positions are unable to do so in any meaningful sense. Many times those stakeholders are faced with a take it or leave it proposition.¹⁸² Even those stakeholders who have the opportunity to negotiate with the corporation may be prevented from achieving meaningful protection as they cannot foresee preserved risks or protect themselves effectively.

ii. Legislation

Given contracting is not always effective at protecting stakeholders, further protections are necessary. The use of legislation provides another tool for ensuring that stakeholder interests are not disregarded. According to Daniels, “a preferable way of thinking about stakeholder injury is through the prism of contractual failure... [as such] state intervention expands the range and effectiveness of instruments that can be used to protect stakeholders and improve societal welfare.”¹⁸³ In situations where contracting is unable to provide an effective protection mechanism legislation has been used and there exists an extensive body of law that ensures that stakeholders are not disregarded.¹⁸⁴

iii. Lobbying and the Political Process

Although legislation provides a good deal of protection for stakeholders, new circumstances may arise where stakeholders are put at additional risk. In those situations, the ability of stakeholders to engage in the political process provides a further mechanism of protection.¹⁸⁵ Many stakeholder groups are part of larger concerted political lobbying organizations.¹⁸⁶ These groups are able to exercise considerable political pressure on governments to enact legislation that protects their interests. As noted by Professor Fisch, “[o]ther corporate stakeholders may have particular advantages in political participation relative to shareholders. Their interests may be aligned along a range of political issues. They may be repeat players. They may have greater stakes.”¹⁸⁷ In contrast, shareholders are for the most part scattered individuals and organizations with little or no political voice.

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

¹⁸² *Green, supra* note 170 at 1418.

¹⁸³ *Daniels, supra* note 168 at 317.

¹⁸⁴ The main example is the oppression remedy. See also, *MacIntosh Fiduciary Duty, supra* note 155 at 453.

¹⁸⁵ Stephen Bainbridge, “In Defense of the Shareholder Wealth Maximization Norm: A Response to Professor Green” (1993) 50 Wash & Lee L Rev 1423 at 1443 [*Bainbridge I*].

¹⁸⁶ *Ibid.* at 1444.

¹⁸⁷ Jill Fisch, “Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy” (2005) 21 J Corp L 637 at 666 [*Fisch*].

Unlike corporate law reforms, however, social welfare legislation of this period sought to cabin managerial discretion over important aspects of hiring, operations and production. Although this vast array of social welfare legislation is not corporate law *per se*, it remains a vibrant constraint on managerial decision-making, adopted in the name of non-shareholder constituencies of corporations.¹⁸⁸

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

Government also provides a better forum for making trade-offs between the various interests at stake.¹⁸⁹ Directors are ill suited at making determinations of public welfare as they lack the necessary information, training and resources to do so effectively.¹⁹⁰ Politicians and legislatures are much better positioned to make these types of decisions. They are able to debate and research a wide array of solutions and decide on the best alternative. They are also politically accountable for any decisions that they make.¹⁹¹

D. Shareholders Bear the Greatest Risk

The preceding part outlined various mechanisms that protect the interests of stakeholders. This part will argue that in the change of control context, shareholders find themselves in the position bearing the most risk.¹⁹² Unlike stakeholders who are afforded the protections mentioned above, shareholders are left almost exclusively to the mercy of directors. Given shareholders' vulnerable position, the most effective way of protecting their interests in the change of control context is through an exclusive fiduciary duty to maximize shareholder value.

Shareholders do not have the ability to contract with the corporation. When purchasing shares, the corporation always sets the terms and there is no ability to alter them. As such, shareholders do not have the ability to protect themselves through contract. This leaves them to rely upon legislative and market-based protections. However, as argued above, these protection mechanisms may not function effectively in the change of control context due to agency problems and concerns regarding self-interested directors.¹⁹³

Shareholders also have the most to lose because of their residual claimant status. The nature of shareholders' residual claim means that they are only entitled to what is left

¹⁸⁸ *Winkler, supra* note 19 at 119.

¹⁸⁹ *MacIntosh Fiduciary Duty, supra* note 155 at 454.

¹⁹⁰ *Ibid.*

¹⁹¹ *Ibid.*

¹⁹² Susan Barrett, "Fiduciary Duties and Stock Warrants: A Fine Distinction between Shareholder Rights and Contract Rights" (1991) 21 *Stetson L Rev* 253 at 271.

¹⁹³ See Section III, Part A.

after all fixed claims have been paid off.¹⁹⁴ Shareholders are the only corporate constituents to make investments in the company without any contractual guarantee of a specific return.

Given shareholders vulnerable position, they have a vested interest in monitoring board actions to ensure that directors remain accountable. However, the widely dispersed nature of shareholders makes it difficult and expensive to do so effectively.¹⁹⁵ Unlike other stakeholders who have a greater ability to mobilize to protect their interests, collective action problems prevent shareholders from achieving meaningful oversight of directors.¹⁹⁶

Professor Sheehy has argued that shareholders' ability to sell their stock results in less risk compared to other stakeholders who are unable to leave their investment easily.¹⁹⁷ Although shareholders are free to sell their shares at any point, they will likely still bear the costs of director misdeed at the time of their exit. In addition, shareholders will not have all the necessary information to make a proper determination of whether or not to sell off their shares. Finally, as pointed out by Minow, the rise of institutional investors "has given us a class of shareholders who are just too big to sell out of a company every time they disagree with management."¹⁹⁸

Fiduciary protection is the most effective means of ensuring that shareholder interests are not subverted. If directors are aware their actions will be monitored against an easily determinable standard, they will be less likely to subvert the interests of shareholders. According to Professor Fisch, fiduciary duties are particularly well suited for protecting shareholder interests:

Because the interests of managers, employees, creditors, customers, and suppliers, are adequately protected through other institutions, there is little need for judicial intervention. Shareholders, however, are relatively disabled from using these institutions effectively. As a result, shareholder primacy affords shareholders access to other institutional actors: the courts. Fiduciary duty cases provide a mechanism through which shareholders can trigger a lawmaking process that protects their distinctive interests.¹⁹⁹

Through the use of the courts, shareholders can obtain remedies for director misbehaviour. Collective action problems will be minimized, as judicial redress does not require the mobilization of all shareholders. Through devices such as securities class action, courts provide individual investors an effective remedy for director misbehavior.

¹⁹⁴ *Van Der Weide, supra* note 157 at 57-58.

¹⁹⁵ *Ibid* at 1442.

¹⁹⁶ *Bainbridge I, supra* note 185 at 1442.

¹⁹⁷ *Sheehy, supra* note 116 at 216.

¹⁹⁸ Neil Minow, "Shareholders, Stakeholders, and Boards of Directors" (1991) 21 *Stetson L Rev* 197 at 227.

¹⁹⁹ *Fisch, supra* note 187 at 668.

CONCLUSION

In conclusion, this paper raises a number of concerns with regard to the fiduciary duty set out in the *BCE* decision. In particular, it was argued that the indeterminate nature of the *BCE* duty left directors with little guidance for dealing with change of control transactions. In addition, the court's use of competing theoretical conceptions of the corporation was criticized for further complicating the meaning of the decision.

The paper went on to argue that directors' fiduciary duties should require them to focus exclusively on increasing shareholder value in the change of control context. The main justification for such a rule is that it provides an enforceable standard for evaluating the actions of directors. Shareholders require an exclusive fiduciary duty as they face the greatest risk of their interests being overlooked. In contrast, fiduciary protection is not necessary for stakeholders as they have a variety of other mechanisms to ensure that their interests are not disregarded.

In *BCE* it seems as though the Supreme Court attempts to steer Canadian corporate law towards a more stakeholder friendly model.²⁰⁰ If this is indeed the case, questions emerge as to whether the courts are the best institution to make such policy decisions. The current corporate governance system in Canada is shareholder focused. The overarching role of shareholders in corporate governance is the result of not just fiduciary duties, but other market and legal mechanisms. Shareholders have the ability to vote on many fundamental transactions and are free to call a meeting and discharge directors. Securities law places significant importance on protecting shareholder interests in the change of control context. There are also a variety of market forces that align the interests of directors with that of shareholders.²⁰¹

Although stakeholders have rights under corporate law, they are largely remedial in nature. The oppression remedy provides stakeholders with a tool to redress corporate wrongs perpetrated against them but does not give them a say in how the corporation is to be governed.²⁰² Only shareholders have been given rights, which allow them to impact the governance of a corporation.

If Canada prefers to introduce a corporate governance model that gives more say to various stakeholders, fundamental changes to corporate and securities laws are required. Simply altering the fiduciary duty is not enough. All the Supreme Court has achieved

²⁰⁰ See note 125.

²⁰¹ See Section III, Part 1.

²⁰² At this point creditors are the only stakeholder group to have been approved as "proper persons" to make oppression claims. Even so creditors face an uphill battle to gain standing as the courts have developed a series of restrictive rules to ensure that ordinary debt claims are not brought under the oppression remedy. See Markus Koehnen, *Oppression and Related Remedies* (Toronto: Thomson Carswell, 2004).

through its articulation of fiduciaries duty in *BCE*, is an indeterminate standard which compromises the ability to effectively monitor boards.

In addition, the decision as to whether a stakeholder or shareholder approach should be adopted in Canada is better undertaken through parliamentary process. When the United Kingdom decided to alter their corporate fiduciary duties, they commissioned a parliamentary committee to research and recommend a course of action.²⁰³ The changes were debated in parliament and ultimately approved. Given the complicated nature of corporate legislation, parliament is better suited at making these types of decisions. Unfortunately this was not the case and we are now left waiting on the courts to further specify the content and operations of the uncertain BCE duty.

²⁰³ See generally Sarah Worthington, "Reforming Directors' Duties" (2001) 64 Mod L Rev 440.