

## CHALLENGES TO THE CITADEL: A BRIEF OVERVIEW OF RECENT TRENDS IN CANADIAN CORPORATE GOVERNANCE \*

Ronald J. Daniels and Edward J. Waitzer †

### I. INTRODUCTION

Politicians, bureaucrats, owners, managers and employees are becoming increasingly concerned with the capacity of Canadian corporations to survive and prosper in the twenty-first century. By and large, the attention focused on competitiveness has developed from the rapid international integration of goods, capital and service markets. This integration has resulted in the creation of a new borderless world, in which consumer preferences reign supreme and in which those corporations that fail to anticipate, shape and respond to these preferences with cost- and quality-competitive products face certain failure.<sup>1</sup> Concern over the survival of national firms commands widespread societal attention because of the dependency of many core public policies on the economic surplus generated by robust private markets.<sup>2</sup>

Given the focus on globalization and competitiveness, it is not at all surprising that academics have expended considerable energy identifying and analyzing the determinants of national economic success in this new international order.<sup>3</sup> Although the composition

---

\* This article was completed in January 1993 and is current as of this date. An earlier version of this article appeared in [April 1993] 1 *Corporate Governance — An International Review* 66.

† Ronald Daniels is Associate Professor of Law and Director of the International Business and Trade Law Programme at the Faculty of Law, University of Toronto. Edward Waitzer is Chairman of the Ontario Securities Commission. At the time this article was written, Edward Waitzer was a partner at the law firm of Stikeman, Elliott.

<sup>1</sup> Kenichi Ohmae, *The Borderless World* (New York, Harper Business, 1990); Michael Porter, *The Competitive Advantage of Nations* (New York, The Free Press, 1990).

<sup>2</sup> This issue is discussed at length in Ronald Daniels and Robert Howse, "Reforming the Reform Process: Privatization in Central and Eastern Europe" (1993), 25 *N.Y. Internat'l J. L. & Pol.*, 27.

<sup>3</sup> See Porter, *supra*, footnote 1. For a Canadian perspective on the issue, see Joseph D'Cruz and Alan Rugman, *New Compacts For Canadian Competitiveness* (Toronto, Kodak

of the basket of favoured policies varies from scholar to scholar, most accord at least some importance to the quality of the system of corporate governance that obtains in a given country. Tracking the modern use of this term, most scholars look beyond the mere operation of a firm's *formal* governance apparatus (*i.e.*, the board of directors) and consider how a wide range of market (*e.g.*, capital, product, managerial and takeover markets), legal (*e.g.*, derivative and personal suits) and political (*e.g.*, shareholder voting) devices combine to discipline managerial behaviour.

In the main, the recent attention devoted to corporate governance and competitiveness is just the next chapter in a very long and noble debate in the United States over the accountability of the modern corporation. This debate is rooted in the seminal work of Adolph Berle and Gardiner Means — *The Modern Corporation and Private Property*.<sup>4</sup> To Berle and Means, the fact that the equity of most American corporations was splintered into multiple, low stakes holdings meant that shareholders were unable to exert meaningful control over management — hence the saliency of their memorable phrase “the separation of ownership and control”.

Although Berle and Means' attention to accountability in the corporation has undoubtedly defined the intellectual agenda of North American corporate scholars for well over half a century, the validity of their analysis, as well as the policy prescriptions that were predicated on it, have not gone unchallenged. Some scholars, for instance, rejected Berle and Means' argument for more extensive government regulation by expressing faith in various refinements to traditional governance mechanisms. Many such suggestions turned on bolstering the role played by independent directors.<sup>5</sup> Later, other scholars pointed to a range of

---

Canada, 1992). For a critical assessment of the linkage made by some scholars between international competitiveness and corporate governance, see R.J. Daniels, “The ‘Crisis’ in Canadian Corporate Governance” (August 1993), 51 *Director* 1.

<sup>4</sup> (New York, MacMillan, 1933).

<sup>5</sup> See, for instance, Mel Eisenberg, “Legal Models of Management Structure in the Modern Corporation: Officers, Directors and Accountants” (1975), 63 *Cal. L. Rev.* 375. The claim that independent directors will improve corporate governance is not, however, uncontroversial. See Victor Brudney, “The Independent Director — Heavenly City or Potemkin Village” (1982), 95 *Harv. L. Rev.* 597; and Kenneth Scott, “Corporation Law and the American Law Institute Corporate Governance Project” (1983), 35 *Stan. L. Rev.* 927. A more recent review of such proposals may be found in Ronald J. Gilson and Reinier Kraakman, “Reinventing the Outside Director: An Agenda for Outside Directors” (1991), 43 *Stan. L. Rev.* 863.

market mechanisms, which they believed could complement and, in some cases, supplant formal governance devices in controlling corporate behaviour.<sup>6</sup> For these scholars, the fact that formal mechanisms of governance are plagued by endemic infirmities was not sufficient to support legal changes. Rather, it was necessary to show that, in tandem, some set of changes could improve on the combined role of law and markets.

Although many of the fads and fashions in the American debate over corporate governance have crossed the border, in many respects the parallel Canadian debate is profoundly different from that in the United States. In large part this is attributable to core differences in the underlying structure of markets, as well as in the *organization* of law and legal institutions *operating* in the two countries.<sup>7</sup> In this article, we survey these differences and then proceed to identify two recent sets of factors that are powerfully modifying the traditional system of corporate governance in Canada — the rise of the institutional investor and the growing socialization of the board. Although some scholars have implied that these two factors can be easily accommodated through more responsible and activist monitoring and intervention by the board, we argue that this task is more vexing than it may at first appear.<sup>8</sup> In tandem, these trends have unleashed powerful tensions and contradictions in the corporate governance system. If corporate governance is an important factor in competitiveness, it is imperative that Canadian policymakers expend greater energy in sorting through the implications of these trends.

## II. CANADIAN MARKET ENVIRONMENT FOR CORPORATE GOVERNANCE

Perhaps the most salient difference in the structure of Canadian

<sup>6</sup> The pioneering work is by Henry Manne, "Mergers and the Market for Corporate Control" (1965), 73 J. Pol. Econ. 110. See also: Michael Jensen and William Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure" (1976), 3 J. Fin. Econ. 305; and Frank Easterbrook and Daniel Fischel, *The Economic Structure of Corporate Law* (Cambridge, Mass., Harvard University Press, 1991).

<sup>7</sup> See Ronald Daniels and Jeffrey MacIntosh, "Toward A Distinctive Canadian Corporate Law Regime" (1991), 29 Osgoode Hall L. J. 863.

<sup>8</sup> Donald Thain and David Leighton, *The Director's Dilemma: What's My Job* (London, National Centre for Management Research and Development, The University of Western Ontario, 1991). James Gillies also discusses the new board but is more sensitive to conflicts and tensions: James Gillies, *Boardroom Renaissance* (Toronto, McGraw-Hill Ryerson Ltd., 1992).

and American markets is the much higher levels of share concentration: 14% of the companies listed on the Toronto Stock Exchange ("TSE") 300 are widely held; 60.3% are controlled by a single shareholder or group of shareholders with legal control (*i.e.*, more than 50% of the voting shares); and 25.4% are controlled by a single shareholder or a group of shareholders with effective control (*i.e.*, between 20% and 49.9% of the voting shares). In stark contrast, of the companies included in the *Fortune* 500, approximately 63% are widely held, 12% have a shareholder or group with legal control, and 18% have a shareholder or group with effective control.<sup>9</sup>

The differences in share ownership concentration suggest that the long-standing American concern with shareholder capacity to discipline managers for self-indulgent conduct is less relevant in a Canadian setting. Because most large public corporations in Canada have a shareholder with legal or effective control, shareholders will face fewer difficulties in detecting management misconduct; consequently, they will also have less difficulty initiating action aimed at disciplining errant management.<sup>10</sup> Knowing full well that controlling shareholders can vote a stubborn board out of office at the next annual meeting, directors will faithfully implement the controlling shareholders' desires. In these terms, there has been little need to resort, as American shareholders must, to expensive and traumatic hostile takeover bids in order to effect a management change.<sup>11</sup> A simple phone call from the controlling shareholder should suffice.

However, the fact that most Canadian companies are not plagued by accountability problems along the shareholder-manager axis does not mean that accountability is never at issue in the Canadian context. Nor has it led to demonstrable gains in corporate managerial performance. Rather, the crucial axis for conflict has simply shifted to that linking controlling shareholders (served by management) with other investors, namely minority shareholders or (to a lesser extent) creditors.<sup>12</sup> In both cases, the

<sup>9</sup> Daniels and MacIntosh, *supra*, footnote 7, at p. 884.

<sup>10</sup> A shareholder with a controlling block of shares has strong economic incentives to undertake an appropriate level of monitoring and, if misconduct is observed, such shareholders are not dogged by some of the serious collective action problems that impair activism in the widely held company.

<sup>11</sup> This is borne out empirically. Of the 1,148 Canadian merger and acquisition transactions tracked in the Venture Economics database in 1989, only 7 resulted in management resistance or in the making of a competitive bid. Daniels and MacIntosh, *supra*, footnote 7, at p. 887.

<sup>12</sup> *Ibid.*, at pp. 884-8.

tighter rein that controlling shareholders wield over managerial actions poses risks (in the form of an increased likelihood of bloated compensation arrangements, unfair self-dealing transactions, or unanticipated changes in shareholder risk-taking). In any event, fairness as between controlling and minority shareholders, rather than irresponsible managerial performance, has become the central focus of external constraints on corporate conduct.<sup>13</sup>

Exacerbating the fairness problems related to share ownership concentration are the tensions spurred by highly interconnected (and interdependent) corporate empires. Of the top 100 most profitable companies in Canada in 1987, 45 held 10% or more of the voting shares of another company on the list, although seldom holding 100% of the shares.<sup>14</sup> The ties created by cross-ownership are strengthened by an extensive pattern of inter-linked directorships. In percentage terms, 71.1% of Canadian board appointments were held by directors with only one appointment, 17.5% by directors with two appointments and 11.4% by directors with three or more appointments. In contrast, American data reveal corresponding figures of 81.8%, 11.1% and 7.1% respectively.<sup>15</sup>

The concentrated power of the Canadian conglomerates (and the major Canadian banks, whose support was a pre-condition of the massive acquisition exercises of the last decade) is graphically illustrated by the Hees/Edper empire; in 1989, the group controlled more than 350 operating companies (almost always with well under 100% control), spanning a wide range of industries, and controlled 8.31% of the companies listed on the TSE 300.<sup>16</sup> Further, one of the principals of the Hees/Edper group holds more directorships (9) than any other director of companies listed on the TSE 300.<sup>17</sup>

The final significant characteristic of the Canadian market environment is the pervasiveness of thinly traded stocks. Fowler and Rorke, for instance, found that only 5.3% of the stocks listed on the TSE (the largest Canadian stock exchange) were traded in

---

<sup>13</sup> It is interesting to speculate on the extent to which this preoccupation of the Canadian regulatory framework has distracted owners and policy-makers from performance oriented concerns.

<sup>14</sup> Daniels and MacIntosh, *supra*, footnote 7, at p. 888.

<sup>15</sup> *Ibid.*

<sup>16</sup> Gillies, *supra*, footnote 8, at p. 110. The data on control of the TSE 300 are cited in Gillies at pp. 108-9, and were derived from Edward Jeffries, *The Edper Group: An Industry Overview* (Toronto, Walwyn Stodgell Cochran Murray Ltd., May 14, 1990).

<sup>17</sup> Daniels and MacIntosh, *supra*, footnote 7, at p. 888.

deep markets; of the remainder, 35.3% were moderately traded and 59.4% were infrequently or thinly traded.<sup>18</sup> As Coffee has observed, the effect of liquidity problems on corporate governance is profound; by increasing the cost of exit, the attractiveness of “voice”, in this case meaning governance activism, is heightened.<sup>19</sup>

### III. THE CANADIAN LEGAL ENVIRONMENT FOR CORPORATE GOVERNANCE

Another set of factors impacting on the distinctive features of corporate governance in Canada is found in law and the nature of legal institutions.<sup>20</sup> Although superficial examination of the legal regime governing Canadian corporations reveals striking similarities to that found in the United States — *e.g.*, corporate statutes containing the standard mix of the broad fiduciary duties of care and loyalty; restrictions on self-dealing transactions; and shareholder voting and initiation rights — there are many important differences in the legal regimes of the two countries that are obscured by focusing solely on the content of corporate statutes.<sup>21</sup>

In the United States, states are responsible for administration of corporate law. Owing to the range of benefits that can be realized from incorporation activity, individual states vigorously joust with one another to enhance the size of their charter market share.<sup>22</sup>

<sup>18</sup> Fowler and Rorke, “Insider Trading Profits and the Canadian Equity Market”, unpublished draft, November 1985.

<sup>19</sup> John Coffee, “Liquidity versus Control: The Institutional Investor As a Corporate Monitor” (1991), 91 *Col. L. Rev.* 1277. Black argues that the tension between liquidity and “voice” has become muted, if it exists at all. In his view, institutional investors should have some liquidity (although in many instances it is no longer relevant) *and* some influence. Bernard S. Black, “Agents Watching Agents: The Promise of Institutional Investor Voice” (1992), 39 *U.C.L.A. L. Rev.* 81.

<sup>20</sup> Law and legal institutions are discussed briefly in Daniels and MacIntosh, *supra*, footnote 7, at pp. 892-900.

<sup>21</sup> The similarity in the content of corporate statutes is not at all surprising given the reliance of the framers of the pre-eminent model of corporate law in Canada, the Canada Business Corporation Act, on American precedents. See acknowledgement, Robert Dickerson *et al.*, *Proposals for a New Business Corporations Law for Canada* (Ottawa, Information Canada, 1971), p. iv.

<sup>22</sup> Although the desirability of charter market competition among states is controversial, there is little disagreement over the positive claim that competition, in fact, exists. See, William Cary, “Federalism and Corporate Law: Reflections Upon Delaware” (1974), 83 *Yale L. J.* 663; Ralph Winter, “State Law, Shareholder Protection, and the Theory of the Corporation” (1977), 6 *J. Legal Studies* 251. The leading empirical analyst of the American Charter Market is Roberta Romano. See, for instance, “Law as a Product: Some Pieces of the Incorporation Puzzle” (1985), 1 *J. L., Econ. and Organ.* 225.

Ever since the state of New Jersey opted out of the competition, the dominant incorporation jurisdiction has been Delaware. This is not to say that a "good" corporate law alone can secure success; as Romano has shown, Delaware's dominance is due as much to the breadth of judicial precedents it has amassed, the quality of its specialized bar and judiciary, and the various institutionalized linkages it has forged between the legislature and the American corporate law community.<sup>23</sup>

In sharp contrast, the Canadian system of corporate law lacks a lead jurisdiction like Delaware.<sup>24</sup> This lack of jurisdictional specialization is odd given superficial similarities to the United States. As in the United States, corporate law jurisdiction is highly decentralized (each of the provinces, plus the federal government, offers a corporate law) and conflicts-of-law rules ensure that corporate disputes will be adjudicated under the laws of the jurisdiction of incorporation.<sup>25</sup> The predictable effect of weak specialization is underdeveloped corporate law infrastructure, strikingly manifested in the lack of specialized corporate/commercial courts,<sup>26</sup> scant judicial precedent, shallow legislative interest in corporate/commercial matters and sluggish rates of legislative innovation.

Although a number of different theories have been posited to explain the dearth of specialized corporate law institutions in Canada, perhaps the most persuasive is the jurisdictional appetite of provincial securities regulators.<sup>27</sup> Because of blurring in the line that separates securities and corporate law jurisdiction, provincial securities regulators (of which the most important in Canada is the

<sup>23</sup> Romano, *ibid.*

<sup>24</sup> Ronald Daniels, "Should Provinces Compete? The Case for a Competitive Corporate Law Market" (1991), 36 McGill L. J. 130. See also; Jeffrey MacIntosh, "The Role of Interjurisdictional Competition in Shaping Canadian Corporate Law: A Second Look", unpublished manuscript on file with the authors, Spring, 1992.

<sup>25</sup> Roberta Romano, *The Genius of American Corporate Law* (August 20, 1992, draft version of monograph to be published by American Enterprise Institute).

<sup>26</sup> And although the province of Ontario has recently introduced a process by which judges of the trial division can signal an interest in commercial and corporate matters (the "commercial list"), the impact of this self-selection process on judicial decision-making is likely to be minimal. This is because judges on the list will still carry a wide range of generalist responsibilities that will impair concentration on corporate/commercial matters. Further, decisions rendered at the trial level are subject to reversal by generalist judges sitting on the Ontario Court of Appeal and the Supreme Court of Canada.

<sup>27</sup> This point (and other possible reasons for weak specialization) are discussed by Daniels, *supra*, footnote 24.

Ontario Securities Commission) have been able to insinuate themselves into the heart of traditional corporate law matters. For instance, by construing their public interest mandate liberally, Canadian securities regulators have made themselves the *de facto* guardian of the rights of minority shareholders in public companies.<sup>28</sup> As this securities jurisdiction can be validly invoked with the barest of claims (the effects test),<sup>29</sup> the demand for judicial intervention is relatively low.<sup>30</sup>

Apart from the pre-emptive effect on the infrastructure of corporate law, expansive securities regulation has had other important effects on the nature of the corporate governance regime in Canada. For one thing, although the vindication of traditional corporate law concerns through the apparatus of securities regulation may appear desirable because it avoids some of the collective action problems that dissident shareholders wishing to mount a derivative suit confront in the United States,<sup>31</sup> this administrative intervention likely has inflicted costs on the quality of corporate decision-making in Canada. Instead of encouraging Canadian shareholders, directors and managers to experiment themselves with private solutions to conflict-of-interest problems — all of which will occur in the shadow of possible *ex post* judicial review — securities regulators have explicitly nourished the formation and perpetuation of a scheme<sup>32</sup> in which endemic conflicts are resolved by an *ex ante* dialogue

---

<sup>28</sup> Philip Anisman, "The Commission as Protector of Minority Shareholders", *Securities Law: Law Society of Upper Canada Special Lectures* (Toronto, Richard De Boo, 1989), at p. 452; Hudson Janisch, "Reregulating the Regulator: Administrative Structure of Securities Commissions and Ministerial Responsibility", *Securities Law: Law Society of Upper Canada Special Lectures* (Toronto, Richard De Boo, 1989), at p. 97; and Brian Pukier, "Taking Care of Business: An Examination of the Ontario Securities Commission's Public Interest Mandate". Paper on file with authors.

<sup>29</sup> Edward Morgan, "Extraterritoriality and Insider Trading", paper delivered at 1992 International Bar Association Conference.

<sup>30</sup> Historically, structural disincentives to private enforcement, including barriers to class actions and contingent fee arrangements, the risks of costs being awarded against an unsuccessful claimant and limits on damage awards, also explain the lack of demand for judicial relief.

<sup>31</sup> Roberta Romano, "The Shareholder Suit: Litigation Without Foundation?" (1991), 7 J. L., Econ. and Organ. 55.

<sup>32</sup> See, for instance, O.S.C. Policy 9.1 (1991), 14 O.S.C.B. 3345. In these terms, the lack of a clearly developed fiduciary duty from majority to minority shareholders in Canada is curious and may be explained by the pre-emptive effect of detailed administrative agency "fairness" standards. This theme is discussed in Jeffrey MacIntosh *et al.*, "The Puzzle of Shareholder Fiduciary Duties" (1991), 19 C.B.L.J. 86.



conducted between the staff of administrative tribunals and corporate insiders.<sup>33</sup> Ignoring obvious transparency problems, the most serious difficulty with *ex ante* administrative review pertains to its potential debilitating effects on shareholder and directorial responsibility. Put simply, the highly interventionist stance of the provincial securities commissions keeps shareholders and directors suspended in a perpetual state of dependence on the whims and protections offered by a well-intentioned, but often undisciplined, benefactor.<sup>34</sup>

Regulation may have been dealt a severe blow in a recent decision of the British Columbia Court of Appeal. In *Pezim v. British Columbia (Securities Commission)*,<sup>35</sup> the court overturned the findings and orders made by the B.C. Securities Commission relating to alleged insider trading. In its findings, the commission had relied not only on the requirements of B.C. securities legislation but also on the more expansive obligations under policy statements issued by the Canadian Securities Administrators and the Vancouver Stock Exchange. In challenging the practice of the Canadian Securities Administrators to regulate by way of policy statements which have not been sanctioned by a legislature, the court noted that, "Since the legislature has dealt with [the disclosure] issue so carefully, specifically and comprehensively, there is no room for the substitution of a more exacting disclosure requirement than the legislature has imposed. To do so would be an error in law."<sup>36</sup> Not surprisingly, the B.C. Securities Commission is appealing the decision to the Supreme Court of Canada.

The depth of the dependency relationship that has developed between the tightly knit community of securities regulators and corporate actors is reflected in the relatively low number of deriv-

<sup>33</sup> The concentrated ownership/control of Canada's corporate and financial sectors is tracked by a relatively small cadre of lawyers and other professional advisors who help manage these regulatory relationships.

<sup>34</sup> For example, the first oppression action brought under the Ontario Business Corporations Act has languished in pre-trial proceedings for almost a decade. The Ontario Securities Commission took a lead role in the litigation; delays, in part, are attributable to competing claims on the commission's resources. See *Ontario (Securities Commission) v. McLaughlin (Stuart Bruce)* (Ont. Ct. (Gen. Div.)), Action #16256/86.

<sup>35</sup> *Pezim v. British Columbia (Superintendent of Brokers)*; *Page v. British Columbia (Superintendent of Brokers)*; *Ivany v. British Columbia (Superintendent of Brokers)* (1992), 96 D.L.R. (4th) 137, 66 B.C.L.R. (2d) 257 (C.A.), leave to appeal to S.C.C. granted (1993), 98 D.L.R. (4th) vii.

<sup>36</sup> *Ibid.*, at p. 159 D.L.R.

ative suits brought in Canada. Shareholder passivity is especially ironic in light of the widespread inclusion of broadly framed oppression remedies in many Canadian corporate statutes. This remedy redresses many of the wrongs that are the traditional preserve of fiduciary duties carried by the derivative and personal actions. However, in contrast to these conventional remedies, the oppression remedy has several notable substantive and procedural advantages, including a focus on the effects of conduct (rather than underlying motive), a broader range of remedial powers, and the ability of plaintiffs to proceed by way of summary application.<sup>37</sup>

Although the oppression remedy was originally designed to cure the congenital reluctance of Canadian courts to clearly delineate the fiduciary duties owed by majority shareholders to minority shareholders in the closely held company context, the scope and comparative advantages of the remedy have caused courts to permit its application in unexpected contexts (*e.g.*, public companies).<sup>38</sup> Our explanation for the relatively infrequent resort to the courts has been the degree of deference (on grounds of comparative expertise) accorded decisions of the Ontario Securities Commission.<sup>39</sup>

A final, related feature of the legal/institutional structure of corporate governance in Canada is the relatively trivial role played by legislatures in the development of either securities or corporate law legislation.<sup>40</sup> In contrast to the United States, neither the provincial legislatures nor the federal Parliament has shown any sustained interest in corporate or securities law issues (or in

---

<sup>37</sup> Brian Cheffins, "The Oppression Remedy in Corporate Law: The Canadian Experience" (1988), 10 *U. Pa. J. Int. Bus. L.* 305; Jeffrey MacIntosh, "The Oppression Remedy: Personal or Derivative?" (1991), 70 *Can. Bar Rev.* 29; and "Bad Faith and the Oppression Remedy: Uneasy Marriage, or Amicable Divorce?" (1990), 69 *Can. Bar Rev.* 276.

<sup>38</sup> *820099 Ontario Inc. v. Harold E. Ballard Ltd.* (1991), 49 C.P.C. (2d) 239, 50 O.A.C. 254 (Div. Ct.); and *Westfair Foods Ltd. v. Watt* (1991), 79 D.L.R. (4th) 48, 79 Alta. L.R. (2d) 363 (C.A.).

<sup>39</sup> Other structural disincentives to shareholder litigation should also be noted. Limits on class proceedings, contingent fee arrangements and punitive damages, as well as the risk of liability for the defendant corporation's legal expenses are strong deterrents against instigating litigation. It should be noted that the Class Proceedings Act, 1992, S.O. 1992, c.6, permits shareholders to commence class actions and enter into contingency fee arrangements in Ontario.

<sup>40</sup> Nigel Wright, "Regulatory Competition and Regulatory Culture: A Comparative Study of Securities Regulation in Ontario and the United States", LL.M. thesis for Harvard University on file with the authors.

asserting jurisdiction therefor). Although legislative committees have, in the past, been struck to examine corporate and securities law matters, by and large, such legislative initiative or oversight is sporadic and unpredictable.

#### IV. TRENDS IN CANADIAN CORPORATE GOVERNANCE

##### 1. The Rise of the Institutional Investor

As in the United States, there is a growing concentration of share ownership in the hands of Canadian institutional investors — public and private pension funds, mutual funds, insurance companies, banks and near-banks. Although accurate data are elusive, estimates suggest that 50%-60% of the shares of widely held companies traded in deep markets in Canada are held by institutional owners.<sup>41</sup> This datum is comparable to similar statistics in the United States, which show institutions controlling approximately 50% of the equity of all public companies and 70%-80% of the equity of widely held companies.<sup>42</sup>

In the United States, the rise of institutional ownership has received widespread endorsement; by virtue of the size of their economic investment, the depth of their expertise and the duration of their investment, institutional investors are thought to be capable of correcting some of the endemic collective action problems spawned by the gap between ownership and control.<sup>43</sup> In Canada, the potential for institutional activism has been similarly enthusiastic. However, in view of the premium on controlling agency problems along the inter-investor axis in Canada, institutional investors have been regarded as important advocates of minority shareholder rights.

In many ways, institutional activism in Canada is still very much in a nascent stage. As in the United States, the earliest signs of activism were observed in the takeover context. Specifically, under the tutelage of Allinvest Inc., an investment dealer providing governance monitoring services to institutions in exchange for soft dollar commissions,<sup>44</sup> Canadian institutions

<sup>41</sup> "Institutions Flex Market Muscle", *The Globe and Mail*, November 11, 1988, p. B18.

<sup>42</sup> Coffee, *supra*, footnote 19, at pp. 1291-2.

<sup>43</sup> Jayne Barnard, "Institutional Investors and the New Corporate Governance" (1991), 69 N. C. L. Rev. 435. See generally: Coffee, *supra*, footnote 19; Bernard Black, "Shareholder Passivity Reexamined" (1990), 89 Mich. L. Rev. 520; and Edward Rock, "The Logic and (Uncertain) Significance of Institutional Shareholder Activism" (1991), 79 Geo. L. J. 445.

<sup>44</sup> Allinvest receives compensation in the form of fees for trades executed through its office.

were able to register their collective dissent regarding a number of issues: the disparate voting right capital structures implemented to enshrine control without proportionate equity ownership;<sup>45</sup> “unfair” control transactions;<sup>46</sup> and the poison pill plans adopted by several widely held Canadian companies.<sup>47</sup> However, in such instances, institutional activism had to be encouraged by securities regulators and, even then, required the stimulus (and shield) of an intermediary.

The institutional response to poison pills is illustrative. Unlike the United States, provincial securities administrators insisted that corporations obtain the approval of shareholders prior to adoption. Nevertheless, despite vigorous lobbying by Allinvest, the institutions were seldom able to poll more than 45% of the votes and were, therefore, unable to thwart adoption.<sup>48</sup> The only judicial challenge to the validity of a poison pill has yet to come to trial.<sup>49</sup> The relatively lacklustre track record of the institutions may be attributed to the lack of confidential voting and to widespread vote-bundling by companies.<sup>50</sup> However, in some cases, the institutions were able to gain important modifications to the proposed plans that partially addressed their concerns (or, at least, justified their activism).<sup>51</sup> Indeed, it has become routine for

---

<sup>45</sup> See, for example, Hugh Cleland, “Dual Class Capital Companies — Going Vanilla”, [July 1992] *Corp. Governance Rev.* 1. Dual class recapitalization proposed by Crown and Seagram’s were both scuttled by institutional pressure. See: *The Globe and Mail*, April 28, 1986, p. A6; and January 13, 1987, p. B1.

<sup>46</sup> *Canadian Tire Corp. (Re)* (1987), 35 B.L.R. 56 (O.S.C.), leave to appeal refused, April 13, 1987, affg (1987), 10 O.S.C.B. 858.

<sup>47</sup> Jeffrey MacIntosh, “The Poison Pill: A Noxious Nostrum for Canadian Shareholders” (1989), 15 C.B.L.J. 276.

<sup>48</sup> Daniels and MacIntosh, *supra*, footnote 7, at note 131.

<sup>49</sup> *Caisse de dépôt et de placement du Québec v. Inco Ltd.*, December 5, 1988 (Québec S.C.), No. 500-05-0133 54-889. In *Bowater Canadian Ltd. v. R.L. Crain Inc.* (1987), 46 D.L.R. (4th) 161, 62 O.R. (2d) 752, the Ontario Court of Appeal struck down a provision in Crain Inc.’s articles of incorporation which provided for the issue of special common shares, which would entitle the initial holder to 10 votes per share but subsequent holders to one vote per share only. The court held that the “step-down” provision breached the statutory requirement for equality of rights within a class of shareholders and presented a danger of fraud. Given this decision, the lack of subsequent litigation on the validity of poison pills is all the more surprising.

<sup>50</sup> For example, the vote on Inco’s poison pill was tied to receipt of a generous, one-time dividend payment. See discussion criticizing linkage in MacIntosh, *supra*, footnote 47 at pp. 305-12.

<sup>51</sup> For example, typical shareholders’ rights plans are triggered when a bidder acquires a certain percentage of the company’s shares (called a “flip-in” event). When this occurs, all shareholders, except the acquiror, are entitled to certain rights, usually to buy securities of the company at a discount. Institutional investors, have been successful, in some cases, in raising the flip-in point, thus making it more difficult to trigger the plan.

corporations seeking shareholder approval for a poison pill to consult in advance with institutional shareholder representatives.<sup>52</sup>

Having “found their voice” in the poison pill setting, Canadian institutions (mainly the public pension funds) amplified their governance role by intervening in (or, more precisely, by reacting to) conflict-of-interest transactions proposed by controlled companies. These issues facilitate institutional response because they are initiated by the corporation, are relatively discrete and defined, are considered in a “friendly” (often confidential) forum (*i.e.*, securities commissions) and require little more than approval or dissent by the institutions (often prompted by securities commission staff). In contrast, corporate mismanagement problems — the focus of activism in the United States — are considerably more complex to analyze than fairness issues and are hence more costly; as a consequence, they are also much less susceptible to intervention by institutions.<sup>53</sup>

Typically, a public corporation proposing a transaction which may give rise to a “fairness” issue consults with some of its major institutional shareholders prior to any public statement of intent, with a view to obtaining their informal reaction. This consultation may occur before, after, or simultaneously with, any consultations with provincial securities regulators. As contacts between the institutions and Canadian corporate management have increased, Allinvest has become less central to these discussions — although the company continues to serve an important monitoring function through its proxy watch service.

One striking feature of the consultative process surrounding a

<sup>52</sup> See, for example, Catherine McCall, “An Acceptable Poison Pill? TransAlta’s New Shareholder Bid Approval Plan”, [November 1992] *Corp. Governance Rev.* 6. TransAlta approached Allinvest prior to its shareholders’ meeting to approve the plan. It then issued a press release stating that changes to the plan would be made if the plan was approved by shareholders. Allinvest did not oppose adoption of the plan, on the basis of the proposed amendments.

<sup>53</sup> Although this too is changing. Recently, for instance, the American Council of Institutional Investors declared that the focus of the 1993 proxy campaign would be “performance, performance, performance”. See, IRRRC Corporate Governance Newsletter, September, 1992.

In Canada, there have been three recent cases in which institutions became involved in a governance dispute that was centred around performance problems and not coloured to any significant degree by self-interest: Memotec, Sherritt Gordon and Canadian Jorex. Significantly, however, in each case, the initiative was triggered by a non-institutional shareholder or intermediary.

fairness issue is that it is accompanied by relatively scant institutional co-ordination or information-sharing. Another is the degree to which Canadian institutions are reactive, with their agenda determined by corporate management and securities regulators. Unco-ordinated, unilateral reaction obviously dulls institutional focus and leverage in the governance process. As well, without co-ordinated search, analysis and negotiating activity, institutions are making redundant (albeit marginal), and hence economically wasteful, investments in the same basic activities. In sum, were there a way to co-ordinate institutional activity, one predicts that the frequency, depth and quality of institutional voice would commensurately increase.<sup>54</sup>

The issue of unco-ordinated institutional action has received careful attention in the United States. Generally, scholars are divided in their analysis of why institutions are loath to co-ordinate their governance activities. Some scholars ascribe the lion's share of responsibility to innate organizational incentives of the institutions.<sup>55</sup> Others point to a range of legal constraints on institutional co-ordination.<sup>56</sup>

In Canada, as in the United States, it is likely that a range of different constraints explain the antipathy exhibited by institutions towards co-ordination. Legal constraints include the proxy solicitation rules and insider-trading prohibitions. Organizational constraints derive from the impacts of concentrated ownership on the market for portfolio management services and the traditional focus of the institutions on investment in, and management of, low-risk, low-yield government debt instruments, which makes governance activism anathema. And, finally, political constraints emanate from the pervasive concern that institutional activism by public pension funds will be construed as a veiled governmental attack on Corporate Canada.

This latter concern is highlighted by the emergence of the heads of public pension funds as the key "players" in the U.S. corporate

---

<sup>54</sup> Edward J. Waitzer, "Are Institutional Shareholders Really Impacting Corporate Governance?", [1991] *Cdn. Inv. Rev.* 9.

<sup>55</sup> Coffee, *supra*, footnote 19.

<sup>56</sup> Black, *supra*, footnote 43; Mark Roe "A Political Theory of American Corporate Finance" (1991), 91 *Col. L. Rev.* 10; and Michael Jensen, "Eclipse of the Public Corporation" (1989), *Harv. Bus. Rev.* 61. However, see recent revisions by American Securities Exchange Commission to proxy rules: Securities Exchange Act Release No. 31326 (October 16, 1992).

governance process. Without necessarily challenging their effectiveness, the visibility they have sought can largely be explained in the terms of political self-interests.<sup>57</sup> The difficulty is that, while such corporate governance “entrepreneurs” are independent of management, their interests are not always aligned with those of beneficial shareowners.<sup>58</sup> A new set of agency problems along the inter-investor axis could easily emerge.<sup>59</sup> In Canada, investment initiatives of the *Caisse de dépôt et de placement du Québec*, a major public pension fund, have heightened public sensitivity to the use of private savings to further public (*i.e.*, political) objectives, often at the expense of a satisfactory economic return.<sup>60</sup> Suggestions that the Government of Ontario might attempt to exercise similar influence over the investment of public pension funds in that province were met by strong resistance from the investment community.

It is inevitable, however, that appropriate intermediaries will emerge to help institutional investors overcome collective action and legal barriers to increased activism in the corporate governance arena. It has been suggested that the mainstage of the corporate governance debate has shifted from the external monitor of control transactions (augmented by judicial and regulatory scrutiny, particularly in the case of related party transactions) to a renewed emphasis on internal monitoring of managerial performance.<sup>61</sup> Already there is growing evidence of substantial potential gains to be derived from increased institutional activism.<sup>62</sup> Indeed, failure to explore such avenues for

<sup>57</sup> This was first noted by Roberta Romano in “The Future of Hostile Takeovers: Legislation and Public Opinion” (1988), *U. Cin. L. Rev.* 457 at p. 469, note 32.

<sup>58</sup> Waitzer, *supra*, footnote 54, at p. 11.

<sup>59</sup> The problems of monitoring institutional investors were first highlighted by Robert Clark in his book review, “Four Stages of Capitalism: Reflections on Investment Management Treatises” (1981), 94 *Harv. L. Rev.* 561.

<sup>60</sup> The 1989 \$1.3 billion takeover of Steinberg Inc., a company now seeking to restructure under the Companies’ Creditors Arrangement Act, was financed by the Caisse. At the time, the transaction was hailed by Jean Campeau, chairman of the Caisse, as the salvation of the company from “outsiders”. See, *The Financial Post*, December 26, 1992, p. 15. Similar investment initiatives of the Caisse include those involving Domtar Inc.

<sup>61</sup> Ronald J. Gilson, “Executive Compensation and Corporate Governance: An Academic Perspective”, draft paper dated October 5, 1992.

<sup>62</sup> See, *e.g.*, Bernard S. Black, “The Value of Institutional Investor Monitoring: The Empirical Evidence” (1992), 39 *U.C.L.A. L. Rev.* 897. The California Public Retirement System (Calpers) recently commissioned a study by John Pound and Lilli Gordon which concludes that changes in an underperforming company’s strategy or governance add value as an investment strategy. As a result, a number of funds are being

increased institutional investor power (and responsibility) may lead to demand for more intrusive reforms to capital market and corporate governance structures.<sup>63</sup>

Recent U.S. experience suggests that enhanced co-operation between corporate management and institutional investors is likely to evolve without the need for such regulatory intervention.<sup>64</sup> With adequate impetus and support, the necessary infrastructure for informed and pro-active relational investing could easily become the basis for an effective institutional investor "voice" in the corporate governance process.<sup>65</sup>

## 2. The Growing Socialization of the Board

The second, widely discussed trend in Canadian corporate governance is the growing level of direct personal liability being placed on the board of directors for myriad harms caused by the corporation. In the main, the beneficiaries of these duties are non-shareholder constituencies affected by the corporation's activities, such as employees, creditors, suppliers, consumers and communities. The source of this burgeoning liability is both the legislature and the judiciary. In terms of the former, one Canadian lawyer has counted 106 different statutes that specify personal liability for directors and officers in Ontario.<sup>66</sup> The statutes articulate responsibility for conduct ranging from environmental spills to occupational health and safety infractions. In terms of the latter, Leon and Flaherty document the proliferation of non-statutory liabilities, mainly framed in tort, that bind directors and officers.<sup>67</sup> This

---

considered by Calpers for such investment. See Randall Smith, "Calpers Mulls Studies in Funds Seeking Changes in Firms' Strategy, Governance", *The Wall Street Journal*, December 31, 1992, p. A3.

<sup>63</sup> See, e.g., *The Report of the Twentieth Century Fund Task Force on Market Speculation and Corporation Governance* (New York, The Twentieth Century Fund Press, 1992) which proposed to enhance long-term oversight by raising capital gains taxes on short-term trading, or recent U.S. legislative proposals (including campaign proposals of President Clinton) to impose a surtax or limit corporate tax deductions on "excessive" executive compensation.

<sup>64</sup> See, e.g., John Pound, "Westinghouse Lights Boardroom Path", *The Wall Street Journal*, December 11, 1992, which describes the constructive process and profound results of institutional shareholders and managers (or directors) working together to address managerial performance shortfalls at General Motors and Westinghouse.

<sup>65</sup> In this regard, the concentrated nature of the Canadian market and legal environments may be viewed as more conducive to effective institutional activism in corporate governance than is the case in the U.S.

<sup>66</sup> D. Palmateer (with the assistance of Grace Kimucho and Anna Torma), "Statutory Liabilities and Offences of Directors and Officers in Ontario", draft memorandum dated October 9, 1990, on file with the authors.

<sup>67</sup> Barry Leon and Patrick Flaherty, "The Expanding Non-Statutory Personal Liability of



expansion in liability has been achieved without any substantial change in the content of the corporate law governing directorial conduct.<sup>68</sup>

The rationale for this expansion of liability has been framed in terms of the growing ascendancy of stakeholder conceptions of the corporation,<sup>69</sup> on the belief that adding direct personal responsibility to general enterprise liability will reduce significantly the level of corporate wrongdoing in society, and on the desire to achieve adequate levels of compensation for victims of corporate wrongdoing. Unfortunately, however, each of these liability theories is beset by serious defects, resulting in a fairly flimsy basis for expansion.

To begin with, the normative legitimacy of stakeholder conceptions of the corporation has been called into question for its inability to control internal agency problems of the firm.<sup>70</sup> Under the traditional normative view of the solvent corporation, only shareholders enjoy a direct claim (secured by a mixture of voting rights and explicit fiduciary duties) on the discretionary (*i.e.*, non-contractual) activities of management. In contrast, exaggerated stakeholder conceptions of the corporation refuse to give any special purchase to shareholder interests. Instead, the corporation exists to vindicate stakeholder interests as manifested in some hypothetical (*i.e.*, self-serving) bargain. However, if shareholders — as a concrete, relatively homogenous set of interests — are not

---

Directors, Officers and Senior Employees”, paper prepared for Canadian Bar Association, Ontario, 1992 Institute Programme, The Law of Agency.

<sup>68</sup> In this respect, the expansion parallels the growth of tort liability claims that precipitated the insurance crisis of the mid 1980s. The expansion of liability was achieved without any meaningful change in the underlying legal rules. See Michael Trebilcock, “The Social Insurance-Deterrence Dilemma of Modern North American Tort Law: A Canadian Perspective on the Liability Insurance Crisis” (1987), 24 *San. D. L. Rev.* 929.

<sup>69</sup> The leading Canadian precedent on takeover defensive tactics, for instance, refers to the ability of managers to vindicate stakeholder interests. See *Teck Corp. Ltd. v. Millar* (1972), 33 D.L.R. (3d) 288, [1973] 2 W.W.R. 385 (B.C.S.C.), which was followed in *Olympia and York Enterprises Ltd. and Hiram Walker Resources Ltd. (Re)* (1986), 37 D.L.R. (4th) 193, 59 O.R. (2d) 254 (Div. Ct.); and *Exco Corp. Ltd. v. Nova Scotia Savings & Loan Co.* (1987), 78 N.S.R. (2d) 91, 35 B.L.R. 149 (S.C.). The oppression remedy has supported a number of creditor claims, although in each case it is unclear whether the court is actually creating quasi-fiduciary duties to creditors or simply permitting aggrieved creditors the opportunity to resolve what are essentially contractual claims through the expedited hearing process of an oppression remedy (see *Canadian Opera Co. v. 670800 Ontario Inc.* (1990), 75 D.L.R. (4th) 765, 75 O.R. (2d) 720 (Gen. Div.).

<sup>70</sup> See Ronald Daniels, “Takeovers and Stakeholders: Contractarianism and Compassion” (1993), 43 U.T.L.J., forthcoming.

to serve as the principals of the corporation, it is difficult, if not impossible, to be able to meaningfully evaluate managerial conduct, thereby impairing the effectiveness of shareholder oversight. To say that managers are loyal to some vague and unarticulated set of stakeholder interests is equivalent to saying that they need not be loyal to anyone. Preferable is a situation in which directors and managers are required to maximize shareholder wealth, subject to whatever contractual and legislative duties are owed to other stakeholders.

A second putative rationale for expanded liability based on general deterrence is equally flawed. To be persuasive, it is necessary to show that there is, in fact, undeterred corporate wrongdoing that is occurring in society and that this wrongdoing can be contained through the addition of mandatory and direct personal responsibility for directors. After all, the fact that a regime of enterprise liability is currently in place means that corporate wrongdoing does not go undeterred, only that some corporate actors, namely investors, are targeted over directors (and managers). Investor liability derives from the loss in security values experienced when a large social liability is imposed on the corporation.

Why might a regime of enterprise liability be insufficient to achieve efficient levels of discipline on corporate conduct? One explanation lies in the bargaining infirmities plaguing investor-director negotiations. It may well be efficient for investors to transfer certain risks to directors, but investor collective action problems impair these negotiations.<sup>71</sup> However, in light of the high levels of share ownership concentration in Canada, this problem is unlikely to be serious. Alternatively, the efficient transfer of risk may be subverted by enforcement difficulties, which require public enforcement and sanctions.<sup>72</sup> However, to be accurate, intervention grounded on this rationale usually implies criminal (not merely civil) sanctions, which to date have rarely been observed in the Canadian context.

---

<sup>71</sup> Many of these themes are developed in Henry Hansmann and Reinier Kraakman, "Toward Unlimited Shareholder Liability for Corporate Torts" (1991), 100 *Yale L. J.* 1879.

<sup>72</sup> See generally: John Coffee "Beyond the Shut-Eyed Sentry: Towards a Theoretical View of Corporate Misconduct and an Effective Legal Response" (1977), 63 *Va. L. Rev.* 1099; and "No Soul to Damn: No Body to Kick?: An Unscandalized Inquiry Into the Problem of Corporate Punishment" (1981), 79 *Mich. L. Rev.* 386; and Christopher Stone, "The Place of Enterprise Liability in the Control of Corporate Conduct" (1980), 90 *Yale L.J.* 1.

We do not mean to say that intervention that increases the responsibility for directors (and officers) on deterrence grounds can never be justified, only that doing so requires some plausible empirical support. Caution in re-allocating responsibility for corporate wrongdoing is especially warranted in view of the desirability of attracting active independent directors into Canadian boardrooms to enhance governance standards, the myriad organizational barriers that impede the board's ability to transmit its preferences to the operational parts of the corporation, and the propensity of lower level managers to engage in sub-goal pursuits.<sup>73</sup>

The final potential ground for intervention, ensuring sufficient compensation for victims of corporate harm, is the easiest to dismiss. In the absence of organized insurance markets, there is little reason to believe that officers and directors are the most efficient risk bearers of corporate wrongdoing. Because all of their personal wealth is at stake and this wealth may not necessarily be substantial, directors (and officers) may be extremely risk-averse. As is well known, managerial risk aversion on its own poses substantial agency problems for the corporation.<sup>74</sup> Further, as one of us has argued elsewhere, the addition of developed insurance markets may do little to control the actual risk borne by directors and officers.<sup>75</sup> Directors' and officers' insurance in Canada is notoriously thin, being plagued by massive exclusions, low coverage ceilings and short coverage periods.<sup>76</sup>

## V. CONCLUSION

In Canada the claim has frequently been made that there is a new paradigm for corporate governance, fuelled in large part by the rise of the new shareholder monitors, in conjunction with a growing sensitivity of the board to its broad societal responsibil-

---

<sup>73</sup> See discussion in Coffee, *ibid.*, at pp. 1132-47.

<sup>74</sup> Yakov Amihud *et al.*, "Risk Reduction as a Managerial Motive for Conglomerate Mergers" (1981), 12 *Bell J. Econ.* 605; and "'Managerialism', 'Ownership' and Risk" (1983), 7 *J. Banking Fin.* 189. See also A. Marcus, "Risk Sharing and the Theory of the Firm" (1982), 13 *Bell J. Econ.* 369.

<sup>75</sup> Ronald Daniels and Susan Hutton, "The Capricious Cushion: The Implications of the Directors' and Officers' Insurance Liability Crisis for Canadian Corporate Governance" (1993), 22 *C.B.L.J.* 182.

<sup>76</sup> Daniels and Hutton, *ibid.*

ities. We do not doubt that these trends are impacting on the governance system, but we do take issue with the nature and extent of the effects. It seems to us that the two trends enumerated above are pulling the board in different, deeply contradictory, directions.

On the one hand, institutional ownership is increasing the responsibility of the board to its traditional principals — the shareholders. While the demographics of corporate control and the activism of securities regulators in Canada may have directed undue attention to the “fairness” of related party transactions, it is clear that, in a setting of rapid globalization, institutional shareholders expect boards to play a leading role in readying corporations for intense product market competition. This role calls out for vigorous strategic leadership that is designed to increase the level of firm specific advantage. In some cases, strategic management is forward-looking and benign, as when it focuses on product development. In other cases, however, strategic management may require wrenching rationalization that will, by definition, inflict severe costs on corporate stakeholders.<sup>77</sup>

On the other hand, the capacity of directors to fulfil the growing expectations of shareholders is being impaired by the mounting level of social liabilities imposed on them.<sup>78</sup> With limited ability to shift risks *via* insurance, individuals invited to serve on corporate boards will have little choice but to refuse to serve, or will do so on the basis that the corporation erect costly liability shields or avoid any danger of running afoul of the law. This latter option may sound laudable but, given the primacy of compensation objectives in the liability calculus, there is little question that a board governed by these concerns will not be assuming sufficient risk.

The pernicious effect of social liability on board decision-making is best illustrated in the context of employee layoffs. In order to improve the competitiveness of the corporation, a board

---

<sup>77</sup> Illustrated by the recent spate of restructuring, generally achieved outside the ambit of corporate law, in many sectors of the Canadian economy (*e.g.*, real estate, natural resources, retail, financial services, steel).

<sup>78</sup> These themes are explained by Ronald Daniels and Edward Morgan in, “Independent Directors Should Stay Gatekeepers”, *The Financial Post*, July 1, 1992, p. 10; and “Directors Face Grab-Bag of Liabilities”, *The Financial Post*, August 12, 1992, p. 10.

may be required to engineer a massive reduction in the workforce — witness the case of GM, IBM and Digital.<sup>79</sup> Such layoffs may be the only way to ensure the survival of the company. Shareholders will expect, indeed insist, that such decisions be made. However, if directors and officers face direct personal responsibility for the loss in employee human capital, they will be understandably loath to sanction these decisions. Hence, the conflict between these two trends.

As the “board overboard” trend in several recent Canadian cases<sup>80</sup> shows, these conflicts have become most readily apparent when a company is heading toward bankruptcy, the time precisely when the board is best equipped to assist in the management of the company.<sup>81</sup> If and when institutional attention focuses more rigorously on improving corporate performance (other than in the “vicinity of insolvency”), the friction between directorial responsibilities and liabilities will become even less tolerable.

It is not atypical of the Canadian economic and regulatory landscape to observe high levels of concentration and regulatory intervention. In the corporate governance context, these tandem features appear to have dampened the entrepreneurial incentives for institutional, as well as directorial, activism. It is to be hoped (and expected) that the global integration of markets will strip away such disincentives and create opportunities for dynamic innovation and reform in corporate governance practices and standards. Legislative review of the conflicting policy effects outlined above would undoubtedly facilitate this process.

More promising, in the near term, is the opportunity for measured collective action by institutional investors to improve corporate performance through constructive oversight. To the extent such efforts lead to a strengthening of boards of directors

---

<sup>79</sup> See *The Globe and Mail*, May 25, 1992, p. B2; *The Wall Street Journal*, December 1, 1992, p. A1; and *The Globe and Mail*, July 24, 1992, p. B9.

<sup>80</sup> For example, directors of troubled Westar Mining Ltd., Canadian Airlines International Ltd. and Peoples Jewellers Ltd. have resigned *en masse* rather than face mounting personal liability. In the case of Peoples Jewellers Ltd., a new board of directors was recruited by the establishment of a financial trust that guarantees payment of their potential liabilities should the company go bankrupt. See *The Globe and Mail*, July 22, 1992, p. B1; July 31, 1992, p. B1; and August 29, 1992, p. B1; and *The Financial Post*, December 26, 1992, p. 16.

<sup>81</sup> See generally: Myles Mace, *Directors: Myth and Reality* (Boston, Harvard University, 1971); and Jay Lorsch with Elizabeth MacIver, *Pawns or Potentates: The Reality of America's Boards* (Boston, Harvard Business School Press, 1989).

(which is a central form of indirect monitoring), private market solutions should attenuate the often misdirected efforts of legislators (and courts) to impose personal liability on individuals who are expected to play such a key role in improving corporate governance.